Working Party on National Accounts

MEASUREMENT OF PENSION LIABILITIES IN COLOMBIA IN THE NATIONAL ACCOUNTS AND IN THE SYSTEM OF GOVERNMENT FINANCE STATISTICS: THE CHALLENGES

JOINT MEETING

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MEASUREMENT OF PENSION LIABILITIES IN COLOMBIA IN THE NATIONAL ACCOUNTS AND IN THE SYSTEM OF GOVERNMENT FINANCE STATISTICS: THE CHALLENGES

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Law 100 of 1993 thoroughly transformed the intervention of Government in the system of Social Protection, including particularly the protection in the area of health and old age. Nevertheless, its application has been gradual in particular in the area of pension, and pension rights generated in the past are still to be found, and will still be around until all potential beneficiaries are dead, which can be still quite long.

The present paper intends to describe the structure of the Colombian pension system and its particularities so as to illustrate the difficulties in representing it properly, both in the National Accounts (real and financial) and in Government Finance Statistics: how National Accounts (real and financial) is picturing it presently in the National Accounts base 2005 series will be presented, as well as the new analysis and its challenges, not the least of it being to have this analysis adopted within the Interinstitutional Committee of Government Finance Statistics that is in charge of producing a unified statistical basis from which to establish National Accounts (including Financial accounts and Balance sheets) and Government Finance Statistics in the near future.

1. The Colombian pension system as a result of law 100 of 1993

1.1. The situation before Law 100

Before Law 100, the pension system operating in Colombia was the following:

For the private sector,

- Since 1967, the Instituto de Seguros Sociales (ISS) provided protection for old age (and also for health), in which benefits were established based on a defined benefit system. Contributions to the system were supposed to be provided by the employer, the employee and also government which would also participate with a specific percentage of the individual contributions. The contributions received would be accumulated (though not on an individual basis) in a special public fund which investment would provide the resources necessary for the future payment of pensions. Retirees would receive a pension calculated through a generous formula based on wages and salaries: contributions were defined as a proportion of wages and salaries, but had a ceiling above which no contribution was collected.

- Additionally, many companies set up additional pension schemes that frequently were unfunded, although some made actuarial calculations and generated special funds in order to be able to make the payments of pensions in the future. The contributions and the benefits were often quite different from those considered in ISS.
Workers on own account were not obliged to be affiliated to any pension system.

For the public sector, the organization was more complex: a collection of specific funds were set up, that attended specific groups of public employees: for the general central government (and many but not necessarily all public entities of the national level), the Caja Nacional de Previsión was set up; for the employees at the local level, each administration set up a specific Caja de Previsión or paid directly pensions without any formal organization; for specific categories of employees, for instance the teachers in public schools, a specific Caja was set up. All these Cajas were supposed to operate on the basis of contributions by employees and employers, although the employers (all public entities) were not always good at paying their contribution… In principle, the benefits were aligned with those of ISS but with time and under the pressure of employees, benefits began to be differentiated and being usually more favorable to employees in terms of retirement age, length of contribution and method of calculation.

In general, there was no clear transferability of rights from one system to another although it was possible to accumulate rights.

In the first years of the operation of the system, it functioned rather properly because there were very few persons having accumulated sufficient rights to claim a pension. Nevertheless, with time, the system totally collapsed: the accumulated reserves of ISS were not as high as expected initially when the system had been set up, as Government never made its contributions, and the reserved funds were used by Government to support construction for low income persons or to stimulate the development of industry, paying interests that were lower than the inflation rate (that was rather high in all this period), leading to a situation in which the funds would be rapidly exhausted. A similar situation prevailed almost for all funds, in part because of the lack of regular funding by employees, and also because of too generous conditions (for instance, only requiring 20 years of contribution), so that a radical change was needed. And that is was brought Law 100 of 1993.

1.2. Law 100 of 1993 and what it changed

Law 100 of 1993 was promulgated at the end of year 1993 and it changed radically the pension system. It set up a totally new basic system and also the paths from the previous system to the new one. These paths will be the object of the following section.

The law set up a dual system of social insurance in pension: a defined benefit scheme and a defined contribution scheme. Each employee would be allowed to choose freely to which system he/she would wish to be affiliated irrespective of his/her employer, public or private. Pension rights would be transferrable; and moving from one system to another would be allowed, provided certain conditions of minimum permanency were fulfilled. Employers and employees would both contribute, and the contributions would be similar irrespective of the system to which the employee was affiliated, which would not be the case of benefits that would be calculated differently. All or almost all the previously existing entities would disappear gradually beginning with the broke ones, but only very few would be authorized to receive new affiliates.

From the implementation of the law, all new employees (and later, also self-employed) had to be affiliated to this new system, and gradually, all employees already affiliated in the old system had to shift to the new one. The rights accrued before the promulgation of the law would usually be maintained.

The defined contribution system would be managed by the private sector: specific entities would be created (Administradoras de Fondos de Pensión) that would manage the funds under the supervision of government. A system of solidarity would be set up so that all persons having contributed during the
required time even on the basis of the minimum wage would have a minimum pension equal to the minimum wage; financed by a retention on the contributions to these funds by all affiliates.

Regarding the defined benefit system, the ISS as well as a few other funds would be maintained and the Government would provide the resources in order for old rights and new rights to be recognized. Most public cajas would disappear progressively and almost all public employees would also have to enter into the new system. Regarding the local administrations, they would be obliged to build up progressively their pension funds, through a specific procedure in which part of the current transfer of resources from the central government would be deposited in a specific investment fund (FONPET) which they would be authorized to use only once their total pension liability had been properly funded.

1.3. The transition system and the pending rights; transfers within the system

For employees having accumulated rights in the previous system, a transitions system was set up. If the entity to which they had been affiliated still existed, they could during some time remain affiliated to it or they could decide to change (without any possibility of returning to the previous fund). Their rights would be bundled up and a complex system of transfers of pension rights was set up: if people moved to the defined contribution system, a bond was emitted (Bono Pensional tipo A) that represented the present value of the accumulated contributions using a predefined actualization procedure. If they later decided to return to ISS (almost the only possibility as the other defined contribution funds were directed to very special groups of persons (teachers, university staff, congressmen, police and army staff), then the bond would be cancelled. If they had previously been employed and had acquired pension rights in other caja or entity, and had moved to ISS before the promulgation of the law (change of employer), then this caja or entity would be obliged to participate pro rata temporis in the payment of the pension. This means that a whole system of transfers of rights was set up.

In some predefined cases, bonds had to be issued representing the accumulated rights calculated following a method defined by law; usually, these bonds were non tradable, and could only be redeemed in the moment the person would retire and require his/her pension. In the defined contribution system, it was possible to retire early, provided a minimum amount had been saved; in that case, the “Bono Pensional” if there were one, had to be traded in the market.

1.4. Handing out the liabilities to a pension administrator

In the following years, important actions were developed in order to put order in the system, both in the private sector and in the public sector.

In the private sector, many big businesses, financial and no financial, had set up pension systems for some or all their employees either as a supplement to the ISS scheme, or as a substitution. In both cases, these pension systems according to these specific conditions were no longer to exist for new employees. All employees should enter the new system. The rights that had been accumulated in the businesses would be maintained and the businesses should gradually fund their pension obligations. The crisis that hit Colombia at the end of the 1990’s accelerated the need for companies to hand out the pension liabilities to pension administrators that could be either insurance companies, managers of non money market funds, or even ISS, usually fully funding the fund so that the total responsibility would be handed out to the fund manager.

In the public sector, the responsibility in terms of pension liabilities was mostly taken over implicitly by general government: some of them were Cajas de pensiones that affiliated employees from various entities, usually within the same sector (for instance mining or telecommunications) and could be assimilated to the general system applicable to specific populations; other corresponded to specific public
entities, usually public companies that had been sold to the private sector but after having excluded an estimation of the pension liabilities (that frequently had not been properly funded (an implicit capital transfer between the receiver of the pension liability and the employer transferring it)).

1.5. Accounting records

In summary, the pending pension liabilities coming from the past were to be found in ISS, in the remaining defined contribution entities, in specific funds managed by managers such as insurance companies and other financial managers, in the accounts of financial and non-financial businesses as specific funds and in the accounts of general government, of local government and of still a few public entities (such as universities). Though these liabilities existed in right, they were not always apparent in the financial statements as most of them were totally unfunded or insufficiently funded. Additionally, the legislation governing the accounting practice was slow in assimilating these totally new situations, and still nowadays, there remains important grey areas in the recognition of pension obligations.

As a consequence, the existing records have not been a reliable source of information on the state of pension liabilities.

In recent years, there is an increasing concern for a proper recording of pension liabilities, mostly from the point of view of government. Intent has been made by the comptroller’s office to oblige the entities (including ISS and the general government) to reveal the amount of their total pension liability, and even to make amortization of these liabilities and create a separate fund in order to pay future liabilities.

After reviewing the present situation in the National Accounts, we will show the conceptual advances that have been made that should give indications on what should be included and what not, and how to manage the changes in pension liabilities in a consistent way.


The compilation of the accounts was not based on a thorough analysis of the functioning of the system, but relied principally on trying to find a meaning to the accounting practices of the different entities involved. Additionally, there was no detailed coordination on the analysis done in the national accounts (real accounts) and the financial accounts as in Colombia, the Statistical Office (DANE) is in charge of compiling the “real” accounts and the Central Bank (Banco de la República) is in charge of the compilation of the Financial aspects of the accounts.

There was no coordinated analysis on the functioning of the pension system, and on the difference in recording social security or social insurance under a defined contribution system or under a defined benefit system. The basic concern was whether the entity being analyzed had set up a special fund or not.

If a special fund was available, then what was known was the movements of the fund as well as the amortization that was applied each year. As a proxy, the value of the pension was estimated as the amortization in the period, and the contribution was estimated as a difference…. As long as no contradiction arose in which case, it was necessary to review the exact situation: possibly affiliates having moved to another entity, or an employer having handed over its pension responsibility to another entity, etc.

For the private funds operating as a defined contribution scheme, the financial statements were used, and on the basis of the changes in the pension funds liabilities and using a statement showing the movements of the funds, an estimation was made of the contributions and the supplements associated with the actual property income (excluding revaluation). Nevertheless, this analysis was short of describing what really was happening: first of all the movements of affiliates between schemes (Social security and
other systems), that should have been analyzed as economic appearance or disappearance of assets, the payment of pensions as a capital to be invested as annuities, etc…

According to the available information, the financial accounts show the situation that is illustrated in the table that follows: All or almost all pension liabilities correspond to pensions funds. The central government also presents a small amount that is decreasing, and all the remaining sectors have very little or no pension liabilities (the value appearing in 2009 for other financial intermediaries seems to be an error in the classification of an investment fund). In order to provide orders of magnitude, the value of GDP in shown, and the percentage that this liability represents: around 22 %

<table>
<thead>
<tr>
<th>Pension Liabilities</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Central Bank</td>
<td>9</td>
<td>8</td>
<td>9</td>
</tr>
<tr>
<td>Monetary institutions</td>
<td>131</td>
<td>145</td>
<td>165</td>
</tr>
<tr>
<td>other non monetary deposit taking institutions</td>
<td>13</td>
<td>13</td>
<td>11</td>
</tr>
<tr>
<td>Other financial intermediaries</td>
<td>1,551</td>
<td>22</td>
<td>28</td>
</tr>
<tr>
<td>Financial auxiliaries</td>
<td>24</td>
<td>25</td>
<td>30</td>
</tr>
<tr>
<td>Insurance companies</td>
<td>28</td>
<td>29</td>
<td>33</td>
</tr>
<tr>
<td>Pension funds</td>
<td>100,862</td>
<td>116,303</td>
<td>128,550</td>
</tr>
<tr>
<td>Central government</td>
<td>7,988</td>
<td>9,282</td>
<td>6,131</td>
</tr>
<tr>
<td>Other central administration</td>
<td>54</td>
<td>55</td>
<td>54</td>
</tr>
<tr>
<td>Local government</td>
<td>1</td>
<td>55</td>
<td>881</td>
</tr>
<tr>
<td>Social security funds</td>
<td>43</td>
<td>45</td>
<td>51</td>
</tr>
<tr>
<td>Public companies</td>
<td>494</td>
<td>489</td>
<td>494</td>
</tr>
<tr>
<td>Private companies</td>
<td>101</td>
<td>108</td>
<td>112</td>
</tr>
<tr>
<td>Foreign owned companies</td>
<td>29</td>
<td>23</td>
<td>24</td>
</tr>
<tr>
<td>Total pension liabilities</td>
<td>112,297</td>
<td>126,601</td>
<td>136,575</td>
</tr>
<tr>
<td>GDP (at current price)</td>
<td>504,647</td>
<td>544,924</td>
<td>619,894</td>
</tr>
<tr>
<td>% of GDP</td>
<td>22%</td>
<td>23%</td>
<td>22%</td>
</tr>
</tbody>
</table>

Source: Colombian Central Bank: Financial accounts

It should be observed that these liabilities only represent those that are totally funded, that is, for which there exist a fund to respond for these obligations (with the exception of bonos pensionales). This means that these amounts do not represent the gross pension obligation of the country. It would be useful to compare these data with those currently used by the Planning Department and the Ministry of Finance in order to estimate what is missing from this estimation, and how much corresponds to social security (that should not appear as a liability but only as a memorandum item).

3. **The decisions for the new National Accounts base, using SNA 2008 as a reference**

1. First of all, it has already been decided to work separately each of the different risks covered by social protection in the National Account, that is old age (pension), health, family and labor risk, establishing for each of them its contributions and benefits, that is, using a
classification somewhat more detailed that the one recommended in SNA 2008 in which all non-pension risks will be treated separately. This will allow making a good follow up of the information and be an important source for government decision on social protection.

2. A working party has been set up, including the Ministry of Finance, the Planning Department (DNP), the Statistics Office (DANE), the General Accounting Office (CGN) and the Central Bank, in order to agree on an analysis of the Social Protection System, and particularly on the Pension System:

- Agree on the borders between Social Security and Employment–related defined benefit pension Schemes in the case of public entities, applied both for the existing system and to the remnants of the previous one; in particular try to define the criteria to establish if a system is relatively close to the ISS/Colpensiones (the main Social Security entity; Colpensiones has taken over the pension activity of ISS) so that a fund might be considered an extension of the Social Security system to a particular specific population, or on the contrary that it is sufficiently different so that it has to be considered as part of an employer-related defined benefit scheme.

- Define the entities to be included in the Social Security Fund Subsector; this means that first a list of all possible entities that intervene in the calculation and payment of pensions (mostly in the public sector) was made, and their specific role was determined: taking also into consideration whether this was its main function or a secondary one;

- Establish the treatment of “Bonos pensionales” and of the sharing of these bonds among entities: the treatment in the accounting System, Government Finance Statistics and in National Accounts might be different, but a clear presentation of the differences should be permanently available; (redemption of bonos pensionales are presently treated as current transfers whereas they should be taken into consideration when they are issued; their redemption represents the transfer of the pension liability from the issuer to the administrator of the fund, a financial transaction); the “bonos pensionales” should not be treated as bonds as they are mostly non negotiable, and represent in fact pension liabilities;

- Treat the resources provided by central government to the entities managing social security as a transfer within government;

- Treat consistently the appearance and disappearance of pension liabilities in the case of persons moving between the Social security Scheme and other social insurance schemes (presently not treated, whereas they have to be treated as appearance or disappearance of liabilities (counterpart: other change in the value of assets…))

- Treat homogeneously the pension liabilities (as a liability if in a social insurance system or as a contingency in case of social security) in each of the systems; and a clear view of the moment of accrual;

- Agree on the different treatment to be given to the changes of the pension liabilities due to the four sources of changes in pension entitlements, which, in the case of Colombia are even five: the current service increase, the past service increase, the decrease due to the
payment of benefits to retirees, the changes due to the mobility of affiliates between systems and the last one that comes from other factors, factors that are reflected in the other changes in assets account, when relating to an employer or to the administrator of a social insurance fund;

- The private defined contribution schemes may pay pensions under three basic schemes: (i) as a flow of payments from the individual pension fund accumulated by each affiliate which amounts are agreed upon between the fund administrator and the retiree, but within certain limits in particular only until the level of the fund only allows for an annuity equal to a minimum wage; (ii) as a transfer of the total amount of the accumulated fund to an insurance company that will be an annuity; (iii) or a combination of both: a payment from the fund of a certain amount, and then as an annuity. For the moment, this transfer to an insurance company is treated as if it were the payment of a pension, generating as a consequence, a bias with too much pension paid and as a consequence, too much insurance premium.

Presently, we are still in the process of understanding the operation of the system, in particular in the case of shared pensions, paid on the pro rata temporis basis that might accrue “current service increase” for entities that have already disappeared but which pensions obligations have been taken over by government. The treatment of the “bonos pensionales” needs also further study, in particular in defining how to apply the accrual basis in their measurement, and accruing year after year the implicit interests that should also be accruing. Government Finance Statistics compilers have to be convinced that not all of them are bonds, as most of them are non-tradable.

We need also, and this is a very difficult but necessary task, to be able to speak all the same language, and though some treatments might be different, we should be able to reconcile the different results that will be produced.