

# FINAL REPORT

PRESIDENTIAL ADVISORY COMMISSION  
ON THE PENSION SYSTEM

2015

♦ **FINAL REPORT**

Presidential Advisory Commission on the Pension System

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♦ **EXECUTION AND EDITION**

Presidential Advisory Commission on the Pension System

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FINAL REPORT

Santiago, Chile, September 2015

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Chapter 2: Context of the Pension System

Chapter 3: Background of the social security industry

Chapter 4: Results of the Pension System: coverage and adequacy of benefits

Chapter 5: Gender and pension gaps in Chile

Chapter 6: Opinions and Perceptions of the Pension System in Chile

Chapter 7: Details of the different instances of citizen participation for the Pension Commission

Chapter 8: Complementary documents for Public Hearings, Volumes 1 and 2.

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## Studies requested by the Commission (Web version)

1. Study on replacement rates and other issues related to the Pension System, (OECD, 2015).
  2. Calculations of life expectancy in selected communities (exploratory exercise), Document prepared by the Presidential Advisory Commission on the Pension System, (Ninoska Damjanovic, 2015).
  3. Population projections for Chile for the 2020-2050 period. (Instituto Nacional de Estadísticas INE, 2014).
  4. Systematization of Hearings and Qualitative Study on Social Security Strategies and Perspectives for Senior Citizens, (Consultora Socialis, 2014).
  5. Report on Survey Opinion Results (STATCOM, 2014)
  6. Survival analysis of Chilean senior citizens based on national evaluation of dependence (Lydia Lera, 2015).
  7. Social security principles and re-reform of pensions in Chile. Report for the Presidential Advisory Commission on the Pension System, (Carmelo Mesa-Lago and Fabio Bertranou, 2015).
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# MEMBERS OF THE PENSIONS COMMISSION



## ► MEMBERS OF THE PENSIONS COMMISSION

The Presidential Advisory Commission on the Pension System is comprised of 24 Chilean and international members<sup>1</sup>:



### **David Bravo:**

President of the Commission. Professor in the Department of Social Sciences, Pontificia Universidad Católica de Chile, Director of the UC Center for Surveys and Longitudinal Studies. He is an economist, with a degree in commercial engineering from P.U. Católica de Chile, and holds a Masters in Economy from Harvard University. Associate researcher at the Population Studies Center (U. of Pennsylvania). He has been a member of the Social Security Consulting Council (since 2009). He was a member of the Presidential Advisory Council for Pension Reform (2006), the Presidential Advisory Council for Labor and Equality (2007 and 2008), the Commission of Advisory Experts on Capacity-Building Policies (2011) and the External Review Commission for the 2012 Census (2013), among other things. He was the founder and director of the Center for Microdata at the Universidad de Chile (until 2013). He has been a primary researcher and advocate for longitudinal studies in Chile (those studies include the Survey on Social Security and the Longitudinal Survey on Early Childhood) and he has published numerous surveys, research studies, and publications on the subjects of the labor market, social security, education, and impact evaluation.



### **Cecilia Albala:**

Professor at the Universidad de Chile, INTA (Institute of Nutrition and Food Technology). Member of the University Senate. She is a medical surgeon and specialist in public health and graduated from the Universidad de Chile, with postgraduate studies in Geriatric Epidemiology from the Universidad de Padua and in chronic diseases Erasmus University of Rotterdam. She is a member of the Academy of Medicine at the Instituto de Chile. She has more than 25 years of experience in clinical and epidemiological research on obesity, the epidemiology of chronic diseases, nutritional transition, geriatric epidemiology and controlled interventions. She has vast experience in studies on aging both in Chile and Latin America.



### **Orazio Attanasio:**

Professor at the Department of Economics at the University College in London. Research Fellow and Director of the Centre for the Evaluation of Development Policies, of the Institute for Fiscal Studies. He is the co-director of the Centre for the Microeconomic Analysis of Public Policy, at the University College in London. He is a Doctor of Economics at the London School of Economics. His research areas include consumption and saving, life cycle, evaluation of policies in developing countries, and applied micro-econometrics. He has carried out studies evaluating the impact of the 2008 social security reform in Chile. He holds more than 100 distinguished publications in books and journals with editorial review boards.

<sup>1</sup> Supreme Decree No. 718, which created the Pensions Commission, indicated that its members also included Mario Marcel and Igal Magendzo. Mario Marcel participated in the Commission until August 2014. Igal Magendzo participated in the Commission from its establishment until December 2014. Both withdrew from the Commission due to scheduling conflicts. José Luis Ruíz, an economist from the University of Chile, replaced Igal Magendzo at the Commission.

**Nicholas Barr:**

Professor of Public Economics, London School of Economics. He is a Doctor of Economics, graduated from the University of California at Berkeley. He is the author of numerous academic articles and books, including *The Economics of the Welfare State* (Oxford University Press, 2012), *Reforming Pensions: Principles and Policy Choices* (together with Peter Diamond, 2008). He is a member of the Editorial Review Board of the *International Social Security Review*, among other academic journals. He has worked in the field of pensions and social policies in relation with Central Europe, Eastern Europe and Russia, England, China, South Africa, and Chile, among other countries. He was a member of the World Economic Forum Global Agenda Councils on Demographic Shifts and on Ageing Society.

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**Fabio Bertranou:**

Director of the International Labor Organization (ILO) for the Southern Cone of Latin America. He holds an undergraduate degree in Economics from the Universidad Nacional de Cuyo and a doctorate degree in Economics from the University of Pittsburgh. His specialty areas are the labor market, social protection, social security and pensions, and he has published work from these fields in numerous academic journals, and book chapters. He has contributed with technical work primarily in Argentina, Brazil, Chile, Paraguay, and Uruguay.

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**Hugo Cifuentes:**

Professor of Social Security Law at the P. Universidad Católica de Chile and at the Universidad Diego Portales. He is a lawyer, graduated from the Universidad de Chile and holds a Doctorate in Law from the Universidad de Complutense in Madrid. He is President of the Commission for Users of the Pension System and Delegate (2003) of the Ibero-American Organization of Social Security (OISS). He was a labor and social security consultant for Banco Estado (1996-2012), consultant for the Undersecretary of Social Security (1996-2004) and District Attorney and Superintendence of Social Security (1992-1994). He is the author of numerous publications in the field of social security law.

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**Regina Clark:**

Coordinator of Institutional Management and Professor of Employment Law and a member of the Center for Studies and Consulting on Labor Relations, Employment, and Social Dialogue (CRL) in the Department of Economic and Administrative Sciences at the Universidad Central de Chile. She is a lawyer graduated from the Pontificia Universidad Católica de Chile and who specializes in employment law and social security law. She was a member of the Presidential Advisory Council for Pensions Reform (2006). She has been a member of the Appeals Court of Santiago (between 2008 and 2011), head of the Legal Department of the Ministry of Education (2008-2010), District Attorney of the Social Security Normalization Institute, which is today the Institute on Social Security (IPS) (1994-2003). She is a member of the Chilean Society of Employment and Social Security Law of Chile and of the Corporation of Specialists in Labor Relations, ex-scholarship recipient of the Universidad de Bolonia, International Training Center of the ILO in Turin, and of the Universidad de Castilla de la Mancha's Chilean division.

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**Martín Costabal:**

Company Director. He is a member of the Financial Advisory Council of the Treasury Department (since 2007) and of the Technical Council on Investments (since 2008). He is a commercial engineer, graduated from the Pontificia Universidad Católica de Chile, and he received an MBA from the University of Chicago. He was the Budgets Director (1981-1984) and the Minister of the Treasury (December 1989 to March 1990). He was a member of the Presidential Advisory Council on Pensions Reform (2006).



**Carlos Díaz:**

Director and Professor, School of Administration, Pontificia Universidad Católica de Chile. He is a commercial engineer, graduated from the Pontificia Universidad Católica de Chile and holds a Masters in Economics from the University of California, Los Angeles. He has been President of the Social Security Advisory Commission since 2010, and is a member of the Risk Assessment Committee (since 1996) and director and advisor of State companies and institutions. His research has specialized in the study of pension modalities in Chile as well as in other countries, and he also dedicates himself to the topics of economy, industrial organization, and economic regulation.



**Christian Larraín:**

Founding partner of the CL Group. He is a commercial engineer, graduated from the Universidad de Chile and holds a Masters in Economics from the Universidad Católica de Lovaina La Nueva. He was a consultant of the supervisor of Banks, and the coordinator of banking and international finances at the Treasury Department. He is Director of the Public Companies System. He has been a consultant for the IBD, World Bank, IMF, and UNDP. He has vast experience as a government consultant and consultant for regulatory bodies of the financial field in Latin America. His specialty areas include financial reform, capital market, and banking regulation and supervision, among other things.



**Costas Meghir:**

Professor of the Department of Economics at Yale University. He received his Doctorate of Economics at the University of Manchester in England. His research areas include econometrics, public policies, labor economics, policy evaluations, and economic development. He has carried out a study evaluating the impact of the 2008 social security reform in Chile. He has close to one hundred distinguished publications in books and journals with an editorial review board. Up until 2011 he was professor of economics at University College London and researcher at the Institute of Fiscal Studies.



**Carmelo Mesa-Lago:**

He is Emeritus Professor of Economics and Latin American Studies at the University of Pittsburgh. He has been a visiting professor, researcher, and conference speaker in forty countries. He is the author of 93 books and 300 academic articles on the economics of social security in Latin America, and other topics. Past President of the Association of Latin American Studies, member of the National Academy on Social Security and of editorial review boards for six academic journals.

**Olivia S. Mitchell:**

She is an International Foundation of Employee Benefit Plans Professor and Professor of Insurance/Risk Management and Business Economic Policy, Executive Director of the Pension Research Council and Director of the Boettner Center on Pensions and Retirement Research, all of which are part of the Wharton School at the University of Pennsylvania. She is an economist, with a doctorate degree from the University of Wisconsin-Madison and did her undergraduate studies at Harvard University. She has studies about multiple countries, including the Chilean Pension System and the recent social security reform. Her research has been published in more than 25 books and 180 academic articles in the main academic journals of the field. She was a member of the Presidential Committee in the United States to strengthen social security and she has served on multiple public and academic boards.

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**Verónica Montecinos:**

She is Chilean, currently working as a Sociology professor at Penn State University. She graduated as a sociologist from the Universidad Católica de Chile, and received a Master's in Sociology and Political Sciences and a Doctorate in Sociology from the University of Pittsburgh. She has published multiple books and articles on issues related to the economics profession, gender equality, and democracy and public policies. The majority of her academic research has been focused on Chile.

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**Leokadia Oreziak:**

A Polish economist. Professor of Economic Sciences and academic of the Warsaw School of Economics (SGH). A specialist in the field of international finances and financial markets. She participated in the Polish social security reform of 2011 and 2013. She is the author of such books as: The Finances of the European Union, The Pension Funds in Poland-the expansion of the product of the global financial institutions 12/2012; Public mechanisms-the 2013 financial crisis; The open pension funds in Poland: the effect of the process of privatization of the pensions 2013; and Open Pension Funds- the catastrophe of the privatization of pensions in Poland (2014).

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**Joakim Palme:**

Of Swedish origin. Professor Political Sciences in the Department of Government of the University of Uppsala in Sweden. He presided over the committee (Kommittén Välfärdsbokslut) named by the Government of Sweden, which was dedicated to the task of creating a general balance for the development of social well-being, 1990-2001, the commission that reformed the pensions in his country. He was professor of the University of the South in Denmark, visiting professor at the University of Oxford in 1990, professor of the University of New South Wales in 1996 and the European University Institute of 1999. Member of the Royal Swedish Academy of Language, History, and Ancient History.

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**Ricardo Paredes:**

Professor, School of Engineering, Pontificia Universidad Católica de Chile. He is an economist and commercial engineer, graduated from the Universidad de Chile and holds a Doctorate in Economics from the University of California at Los Angeles. He has been a member of the Social Security Consulting Council (since 2012) and Coordinator of the Talent and Inclusion Project at the Universidad Católica (since 2012). He was President of the Commission on Student Financing established by the Ministry of Education (2012). He has numerous publications in the field of education, the labor market, and industrial organization.

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**Marcela Ríos:**

National Officer for Democratic Governance, United Nations Program for the Development, Chile. She holds a PhD in Political Sciences from the University of Wisconsin-Madison, a Masters in Social Sciences from the Facultad Latinoamericana de Ciencias Sociales (Flacso) at the Mexico campus, and a Bachelor's degree in Sociology from the University of York in Canada. She became a member of the Boeninger Commission to create a proposal for the electoral system (2006). She is a professor of the doctorate program in Social Sciences at the Universidad de Chile, Advisor and Director of the Women's Community since 2005 and board member of the Fundación de la Familia, Fundación Equitas, and Espacio Público. She participated in the creation of the Report on Human Development in Chile in 2010, "Gender: the challenges of equality," and recently she coordinated the UNDP Assessment Report to the democracy: more and better democracy for an inclusive Chile. She has directed research projects and made publications on comparative politics in Latin America, gender and institutions, gender and politics, and gender quotas, among other things.

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**Claudia Robles:**

CEPAL consultant in the area of social security policies and social development. She is a sociologist, graduated from the Pontificia Universidad Católica de Chile, and holds a Masters in Development Sociology and a Doctorate in Sociology from Essex University in England. She has worked as a researcher and consultant on social policy issues, multicultural issues, and social security issues in the Center on Society and Public Policy of the Universidad de Los Lagos, ECLAC, OAS, and UNICEF in El Salvador. She has various publications on social protection and poverty reduction in Latin America.

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**José Luis Ruiz:**

P.D. in Managerial Science and Applied Economics from the Wharton Business School (University of Pennsylvania) and commercial engineer with a focus in Economics from the Universidad de Chile. José Luis Ruiz is the Academic Director of the Masters in Finance program in the Department of Economics and Business at the Universidad de Chile, where he also holds the position of full-time professor.

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**Claudia Sanhueza:**

Associate Professor of the Institute on Public Policies at the Universidad Diego Portales. She is an economist, graduated from the Universidad de Chile, and holds a doctorate degree from the University of Cambridge in England. She is a researcher at the Center for Social Conflict and Cohesion Studies. She is the author of various research studies in the field of labor economics, education, and political sciences. She was a member of the Presidential Advisory Council on Labor and Equality (2007 and 2008).

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Professor, Department of Economics, University of Maryland (since 2011). Associate Professor at the Pontificia Universidad Católica de Chile, at the UC Center on Surveys and Longitudinal Studies and at the UC Latin-American Center on Economic and Social Policies. He is an economist, graduated from the Universidad de Chile and holds a Doctorate in Economics from the University of Chicago. He was a member of the expert revising committee of the education policies (2011), of the presidential committee for the design of the Ethical Family Income (2010-2012), and of the committee to evaluate the CASEN Survey (2011). He holds numerous publications in his specialty areas: education, the labor market, evaluation of programs, and applied micro econometrics.

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Professor at the Department of Economics and Business at the Universidad de Chile. He is an economist, commercial engineer, graduated from the Universidad de Chile, and holds a doctorate in Economics from the University of California at Berkeley. He is a member of the Social Security Consulting Council. He was a member of the Presidential Advisory Council for Social Security Reform (2006). He was a regional consultant at PREALC and the ILO and an official at CEPAL where he worked as the person responsible for the Division of Social Development. He has various publications in academic journals and institutional publications on labor markets, poverty, employment, social protection, pension systems, and economics of health.

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# PRESENTATION AND ACKNOWLEDGEMENTS

The following report is a response to the invitation that the President of the Republic, Michelle Bachelet, extended to the Commission in late April of 2014.

As the president of the Presidential Advisory Commission on the Pension System, I would first like to express my gratitude to the President for the trust she has placed in the members of this Commission. During this time, we have had the privilege of working on an issue that is hugely relevant to public policy and that is directly related to the wellbeing and quality of life of Chilean citizens.

The Government collaborated with us during the whole time, which allowed us to maintain our autonomy throughout the process. The Commission worked with the Government through the Treasury Ministry and the Labor and Social Security Ministry. I would like to thank the former Ministers of these Ministries, Alberto Arenas and Javiera Blanco, respectively, under whose leadership most of our work was carried out, as well as the former Undersecretary of Social Security, Marcos Barraza. I would also like to acknowledge the support given in the final stage of the Commission's work by the Minister of Treasury, Rodrigo Valdés; the Minister of Labor and Social Security, Ximena Rincón, and the Undersecretary of Social Security, Julia Urquieta, which was truly fundamental. Likewise, this Commission could not have concluded its work without the support of the Director of Budgets, Sergio Granados.

Different public institutions have supported the Commission's work. The Undersecretary of Social Security has offered office space and administrative support for the carrying out of our activities, as well as important assistance with databases, studies and the carrying out of citizen dialogues. I would like to acknowledge the support of Gonzalo Cid, Jeanette Jara, Yani Aguilar, Andrés Larraguibel, Juan Vila, Domingo Claps, Magaly Parada, Claudio Rodríguez, Pablo Chacón, Eduardo Pérez, Cristian Quiriván, Alexander Valdés, Pilar Zamora, Mónica Segura, Tomás Zenteno, Jennifer Contreras, Luis Parrado, Pablo Guerra, Paula Ruz, and the whole team of Welfare and IT Education from the Undersecretary of Social Security. Likewise, the Ministry of Treasury and the Budgets Office have continuously supported our work. Fidel Miranda, Jacqueline Canales, Paula Benavides, Eduardo Román, Leonardo González, Juan Manuel Badilla, Miguel Lorca, Mathieu Pedemonte and Camila Ureta all played distinguished roles in the development of this work.

The Superintendence of Pensions offered continuous support. I would like to thank the former Superintendent, Álvaro Gallegos, as well as the current Superintendent, Tamara Agnic. Likewise, I would like to acknowledge the collaboration of Olga Fuentes, Ximena Quintanilla, Marcia Salinas, Carmen Quezada, Felipe Menares, Pamela Searle and Claudio Palominos.

I also want to acknowledge the cooperation of Claudio Reyes, Superintendent of Social Security; Pamela Gana, Intendant of Workplace Security and Health; and Romy Schmidt, Intendant of Social Benefits from the same institution, as well as Patricio Coronado, Director of the Social Security Institute; Osvaldo Macías, Superintendent of SVS Securities; Jorge Mastrángelo, Chief of the Risk Management Division of the SVS; Bernardo Martorell, Chief of the Health Planning Division from the Undersecretary of Public Health; Verónica Rojas, Chief of the Statistics and Health information Department; Ximena Clark, Director of the INE, and Gustavo Villalón, Department of Population Studies of the INE. The Inter-American Development Bank offered the Commission significant support, by, for example, organizing the seminar in June 2015 and by carrying out fundamental tasks that allowed us to finish our Final Report. I want to particularly thank Koldo Echebarría and Carmen Pagés.

The Commission carried out its work thanks to a team with great technical and human talents. The Executive Secretariat was directed by Margarita Peña; the Technical Secretariat included Eileen Hughes, Paola Langer, Claudia Órdenes and Andrés Otero (who lent his services from the Pension

Superintendence). Michele Benavides and Tamara Cabrera supported the technical work in its final stage. Rigoberto Millacura collaborated with administrative support, together with Cecilia González and Tiare Pino. Lea Sarles Newfarmer and Clemens Vogt were critical for the translation of texts, and Paulina Fuenzalida for their design. In addition, Nicolás Libuy, Javiera Vásquez, Valeria Signorini, Natalie Rebolledo, Teresa Abusleme, Rodrigo Salas, Ninoska Damianovic, Lydia Lera, Valeria Solis and Rosario Undurraga made important contributions to different chapters of the background information of the Final Report. Nicolás Rodríguez and Dominique Lozier participated in the analysis of the Citizen Dialogues. Rubén Pino (Socialis) and Paulina Valenzuela (Statcom) spearheaded the studies developed for the Commission.

The Commission would like to especially acknowledge the participation of the organizations and people who presented at the Public Hearings, and the people who attended the Prior Meetings and the Citizen Dialogues organized in each region. Finally, it would also like to thank those who contacted the Commission with their messages and e-mails. As it is impossible to mention each person who participated in these different instances by name, there is a detailed list in the webpage [www.comision-pensiones.cl](http://www.comision-pensiones.cl).

This work would not have been possible without the huge commitment and enthusiasm of all the members of the Commission. Each one allocated many hours of discussion and time for a pro-bono work of public service. A special thanks to the international members of the Commission, all renowned experts and academics, who worked hand in hand with the national members.

I would like to conclude by thanking our families, offices and all those who witnessed first-hand the dedication that this task required.

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**David Bravo Urrutia**

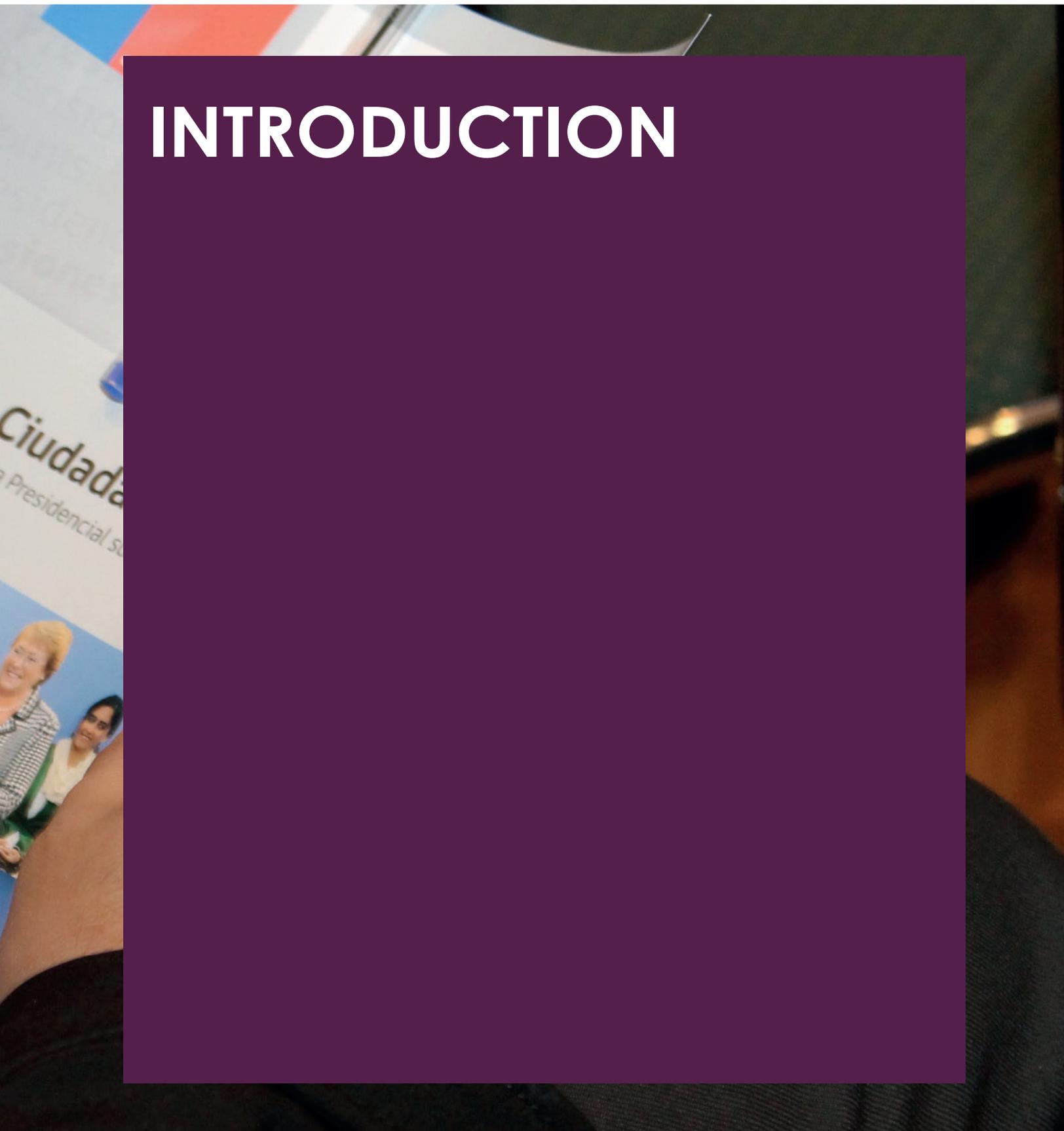
President

Presidential Advisory Commission on the Pension System

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# INTRODUCTION



## ► I. INTRODUCTION

This report describes the main results of the work carried out by the Presidential Advisory Commission on the Pension System, created in April, 2014 at the request of President Michelle Bachelet. As stated in the Commission's mandate, the purpose of the Commission was to study the Pension System that was established by the Decree Law 3.500 from 1980 and by Act 20.255 of the 2008 Welfare Reform, to carry out an assessment of the way these legal norms currently operate, and to formulate proposals to address the deficiencies identified in that analysis.

Given the scope of its mandate, the Commission, which was made up of 24 members (including 15 national and nine international members), focused at first on gathering background information which would allow it to develop a complete diagnosis of the current state of the Pension System. In order to carry out this task, the Commission was given access to a substantial amount of information, coming from diverse official sources such as Ministries and public services, international organizations, think tanks and databases of surveys related to the topics at hand. The information received during the citizen participation process carried out by the Pension Commission was also crucial, and came from individual people, representatives of guild and union organizations, civil society organizations, think tanks, political and governmental authorities, pensioners' associations, non-governmental organizations, and representatives from the Pension Fund Administrators, Insurance Companies, among others.

In parallel, and based on all the gathered information, the Commissioners held meetings on numerous occasions to discuss and agree on a possible diagnosis and on the direction that the final proposals should take. In this stage, the plenary meetings held by the Commission with their national and international members were key for developing the global and specific recommendations presented here.

The Commission's report includes seven sections in addition to this introduction. Section II explains the work undertaken by the Commission, its operating mechanisms and the activities that were carried out. Section III deals with the problem of demographic aging, and how pension systems

are crucial for safeguarding the quality of life and health of senior citizens. Section IV describes the Chilean Pension System, from its origins before the 1981 reform until the most recent modification made in the 2008 reform. Section V includes the Commission's evaluation of the results of the Pension System. Section VI describes the discussion that took place within the Commission regarding the nature of the modifications necessary to improve the Pension System. Section VII presents the specific recommendations developed by the Commission in order to fulfil its mandate and the last part, Section VIII, evaluates the proposed measures in terms of the impact on future pensions and on fiscal cost. The detailed tally of the votes of the Commission's members regarding the proposals that were approved, as well as the minority votes, are included in the final appendix of this document.



In addition to the final report, we are presenting eight chapters that offer an in-depth analysis of the background information that forms the basis of the Commission's recommendations. Chapter 1 presents a global analysis of the main instances of Citizen Participation. Chapter 2 delves into the context of the Chilean pension system and offers a broader perspective on the factors that determine the system's parameters. Chapter 3 explores the main features of the market of the Pension Fund Administrators. Chapter 4 describes the current state of the system in terms of the adequacy of the benefits that it grants, according to various indicators and measures of purchasing power. Chapter 5, in turn, evaluates of the Pen-

sion System from a gender perspective, which is explored in-depth in the chapter. Finally, chapters 6, 7 and 8 offer a detailed view of each of the mechanisms for citizen participation, namely: Public Hearings, Regional Dialogues, messages and mail sent to the Commission, as well as the National Survey (carried out in a total of 3,696 households).

Finally, it is important to note that the information included in this report is the sole responsibility of the Commission, and that, in accordance with Commission's consultative and advisory nature, the results and recommendations included herein are not binding in nature.



# THE WORK OF THE COMMISSION



## ► II. THE WORK OF THE COMMISSION

### A. Background

The policy agenda of the current President of the Republic, Michelle Bachelet, was presented in October of 2013, prior to her election. In the chapter that refers to pensions—entitled “Protection and Opportunities”—the agenda indicates that while the 2008 Pension reform introduced modifications that were oriented towards raising social security coverage for vulnerable groups and towards improving the individual capitalization system, the Chilean Pension System still faces important challenges.

*The agenda refers to the “...Existence of a significant dissatisfaction concerning the quality of pensions, since after years of effort in the labor market, workers see that the pension amount that they receive does not match their expectations, that is to say, that their pension is very low (...). Another pending issue is related to the high rates of evasion and avoidance of contributions among salaried workers, which vary according to economic sector, geographic region, gender, and profession of the affiliate...”.*

The agenda proposes that within the first 100 days of the Bachelet administration<sup>2</sup>, the government will review the pension system “...to ensure that we can aspire to be dignified in our old age and have proper disability and survivor’s insurance. We will therefore commission the preparation of a study of the Pension System to be carried out by a team of national and international experts so that they may propose alternative solutions to these problems...”

The agenda clarifies that in order to achieve a satisfactory solution to these issues, there must be a rigorous analysis that offers an in-depth assessment of the system and that responds to citizens.



<sup>2</sup> See measure No. 17 of “50 Commitments for improving the Quality of Life in Chile for all”. Available at: <http://michellebachelet.cl/pdf/50medidasMB.pdf>

## B. Creation of the Presidential Advisory Commission for the Pension System

El In this context, and on April 29th 2014, the President of the Republic created the Presidential Advisory Commission on the Pension System, an act which was also formalized by the signing of Supreme Decree N° 718, in which the goals, tasks, and skills that guide the Commission's functioning were established.

In this Decree, in its first article, the principal objectives are listed as:

*"...To study the Pension System established in the Law Decree number 3,500 of 1980 and Law number 20,255 of the Pension Reform of 2008, to carry out a diagnosis related to the current functioning of these regulating bodies and to develop proposals aimed at resolving the deficiencies that are identified..."*

The tasks that are assigned in order to comply with this objective were the following:

- a) *Carry out a study and analysis of the observed and projected results of the Pension System, taking into consideration the needs of the population;*
- b) *Develop a diagnosis concerning the attributes, limitations, weaknesses, and challenges of the Pension System;*
- c) *Develop proposals oriented towards resolving the primary weaknesses of the Pension System, identifying as well other complementary measures that prove necessary;*
- d) *Require from ministers, services and public organizations all information deemed necessary for compliance with the assigned mandate;*
- e) *Commission the development of studies from competent organizations that allow for the understanding of citizens' opinions on issues relative to social security;*
- f) *Carry out hearings with civil society organizations, representatives of the labor and corporate world, Pension Fund Administrators, Insurance Companies, experts, and national and international academics in the field;*

*g) Hold seminars, to which noted international experts will be invited, with the goal of understanding the primary trends in the area of pension systems at a comparative level, taking advantage of these instances to resolve conundrums about specific aspects of the Chilean pensions system; and*

*h) Carry out additional tasks that are necessary and pertinent for compliance with its task as advisor to the President of the Republic..."*

Additionally, the mandate establishes that:

*"The Commission must ensure that the proposals it formulates are relevant, concrete, effective, efficient, and viable, and that they are internally consistent, and must specify the gradualness of their implementation. Likewise, it must ensure that these proposals are financially, politically, and institutionally feasible".*

## C. Members of the Commission

The Commission was composed of 24 national and international members:

### » National

David Bravo (who served as President of the Commission); Cecilia Albala; Hugo Cifuentes; Regina Clark; Martín Costabal; Carlos Díaz; Christian Larraín; Ricardo Paredes; Marcela Ríos; Claudia Robles; José Luis Ruiz; Claudia Sanhueza; Jorge Tarzján; Sergio Urzúa; Andras Uthoff.

### » International

Orazio Attanasio; Nicholas Barr; Fabio Bertranou; Costas Meghir; Carmelo Mesa-Lago; Olivia Mitchell; Verónica Montecinos; Leokadia Oreziak; Joakim Palme<sup>3</sup>.

### » Secretary of the Commission

In addition to the Commission members listed above, the Advisory Commission includes an Executive Secretary and a Technical Secretary. The first is represented by Margarita Peña, Economist, and the second is made up of: Eileen Hughes, Sociologist; Paola Langer, Sociologist; Claudia Ordenes, Economist. Additionally, the Advisory Commission included the collaboration—in the form of a service commission from the Pensions Superintendence—of Andrés Otero, Economist.



<sup>3</sup> Mario Marcel was also part of the initial nomination of international members but was unable to participate for work reasons. Additionally, Igal Magendzo participated in the first part of the Commission's work, until January 2015, when the Commission's work period was extended to August 2015, and presented her resignation at that time to her inability to participate for work reasons.

## D. Functioning of the Commission

### 1. General background

The work carried out by the Commission extended from April 29, 2014 until August of 2015, via an extension of its functions through legal mandate Number 14 of January 12, 2015 from the Supreme Decree No. 718 of the Treasury Department.

The work of the Commission during the 16 months of its operation included the following activities:

- » 65 Work Sessions, of which 55 were work sessions with national members and 10 were meetings that included the presence of both national and international members of the Commission.
- » A consultative citizen participation process, with 78 Public Hearings in which experts in the field, social organizations, international

agencies, non-governmental organizations, study centers, representatives from the work and corporate world, Pension Fund Administrators, and Insurance Companies presented. Additionally, 30 Regional Dialogues were held.

- » Requests for and commissioning of background studies to complement the work of the Commission on pensions, and in order to understand the public's opinion about issues relative to social security.
- » An international seminar with experts on the subject.
- » A webpage for the Commission, available as a permanent medium for inquiries.

Additionally, the commissioners met on December 11, 2014 with President Michelle Bachelet, to present the status of their work.

 **Table 1: Summary of activities carried out by the Presidential Advisory Commission for the Pension System**

Activities	Detalle
<b>Work sessions</b>	55 Internal work sessions 10 plenary meetings
<b>Public Participation</b>	<ul style="list-style-type: none"> <li>• 78 Public Hearings in Santiago</li> <li>• 30 Regional Dialogues in each of the countries' regions</li> <li>• Survey of opinions and perceptions of the pension</li> <li>• Webpage: 730 messages received</li> </ul>
<b>Request for background studies</b>	7 Background studies commissioned
<b>Development of International Seminar</b>	«Pension Systems, International and National Trends» June 16th 2015
<b>Audience with President Michelle Bachelet</b>	Meeting with President Michelle Bachelet, December 11, 2014

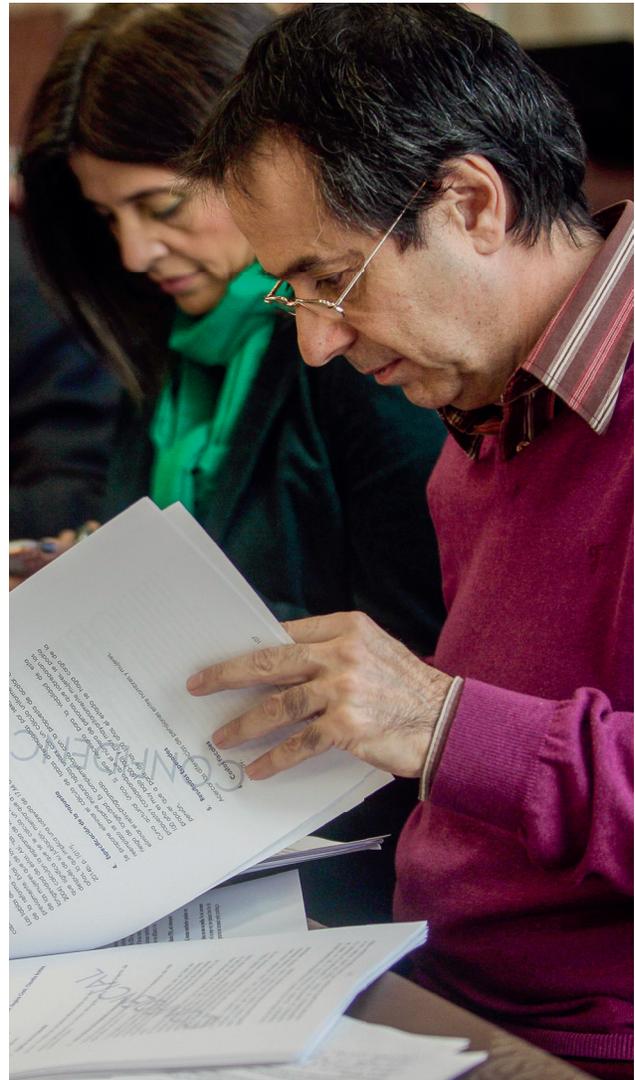
## 2. Work Sessions

The Commission carried out its work in two types of sessions: internal work sessions with the Chilean commissioners and plenary meetings with the participation of both the Chilean and international commissioners.

One distinct characteristic of the Commission is the active role that the President of the Republic assigned to the international commissioners. This role meant that it was necessary for the Commission to adapt its internal communications and its documents so that they were both in English and in Spanish. Likewise, the primary decisions relative to the Commission's work were taken in the expanded plenary sessions of the members.

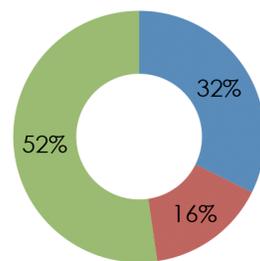
From May until October of 2014, the Commission held almost weekly internal work sessions, principally on Wednesdays and Thursdays. In 2015, the Commission did not meet during the month of February, and instead held its activities in January and from March until August of 2015. There were a total of 55 internal work sessions, and 10 plenary meetings between August 20—21 and December 9-10 in 2014, and May 12-13; 28, 29, 30, and July 31 in 2015.

21 of the sessions were dedicated to Public Hearings, 10 to internal presentations by agencies and experts on subjects linked to pensions and aging, and 34 were dedicated to internal work. (See Graph 1.)



Graph 1:

### Activities of the Presidential Advisory Commission



- Public Hearings in Santiago
- Internal Presentations by related agencies
- Internal work (internal sessions and expanded meeting)

Source: Commission Data

The following table provides a summary of the internal presentations carried out by experts and agencies linked to the topic of pensions.

**Table 2: Internal presentations by agencies related to pensions and aging**

Fecha sesión de trabajo	Presenter
<b>27 August 2014</b>	National Statistics Institute INE Social Security Advisory Council Commission of Pension System Users
<b>24 September 2014</b>	Organization for Economic Co-Operation and Development (OECD)
<b>08 October 2014</b>	Supervisor of Securities and Insurance
<b>08 October 2014</b>	Social Security Institute
<b>09 October 2014</b>	Supervisor of Pensions
<b>12 November 2014</b>	Ministry of Social Development
<b>13 November 2014</b>	Ministry of Health
<b>3 December 2014</b>	Consultant Presentation SOCIALIS
<b>7 January 2015</b>	Presentation by Dra. Ursula M. Staudinger
<b>28 January 2015</b>	Supervisor of Securities and Insurance
<b>18 March 2015</b>	Presidential Advisory Commission for the inclusion of Disabled Persons Superintendency of Social Security National Health Fund

Source: Commission Data

It should also be noted that the needs expressed and the information presented by citizens in each of these instances of citizen participation were all included as input in the Commission's definition of the issues to be discussed as well as in the analysis and discussions in each of the thematic groups.

### 3. Instances of Citizen Participation

One of the Commission's most important activities was the large-scale gathering of information in the context of a process of Citizen Participation. This process reflects the participatory approach that the Pension Commission took in almost of its activities. The Commission chose to focus on participation in response to the current administration's intention to promote participation in all of its Ministries and Services, despite the fact that the Commission on Pensions is not an institution linked to the management or implementation of public policy.

The citizen consultation sessions included the participation of private citizens, representatives from trade unions, civil organizations, research centers, political and governmental authorities, pensioners associations, non-governmental organizations, representatives from the Pension Funds Administrators, and Insurance Companies, among others.

The citizen participation process had various channels for participation: Public Hearing in Santiago, Regional Citizen Dialogues (which included two prior meetings and two regional hearings), and the creation of spaces for consultation through messages and emails. Additionally, the Commission viewed the results of the National Survey on the Opinion and Perception of the Pension System in Chile as a part of this participation process, which was representative at the national level. These channels of participation are detailed in the following Table.

**Table 3: Ways of Citizen Participation**

Form of Participation	Participation
<b>Hearings in Santiago</b>	78 Organizations (254 people attended)
<b>Prior Regional Meetings</b>	1.416 people attended (to a total of 15 Prior Meetings)
<b>Regional Audiences</b>	1.170 people attended (a total of 15 Regional Hearings)
<b>Messages via Website</b>	730 messages
<b>Documents received</b>	88 documents
<b>National Survey on the Opinion and Perception of the Pensions System in Chile</b>	3.696 households

Note: The number of calls, emails and documents received corresponds to the total recorded on July 20, 2015.

Source: The Commission's own work.



## 4. Public Hearings

The Public Hearings in Santiago were held between the May 28 and August 14, 2014<sup>4</sup>. Attendees were given the opportunity to present in front of members of the Pensions Commission, domestic and international experts on the subject, representatives, social organizations, international agencies, non-governmental organizations, research centers, representatives

of the working world, the business sector, Pension Fund Administrators, and Insurance Companies. In total, there were 78 public hearings.

The following table displays a list of the organizations that participated in the Public Hearings of the Pensions Commission, classified according to categories<sup>5</sup>:

 **Table 4. List of the organizations that participated in the Public Hearings**

Type of Organization	Presenter
<b>Union Organizations and Academic Associations</b>  	Central Unitaria de Trabajadores (CUT)
	Agrupación Nacional de Empleados Fiscales (ANEF)
	Unión Nacional de Trabajadores (UNT)
	Confederación General de Trabajadores Públicos y privados (CGTP)
	Confederación Nacional Unitaria de Trabajadores del Transporte y Afines de Chile (CONUTT)
	Federación Nacional de Profesionales Universitarios de los Servicios de Salud (FENPRUSS)
	Confederación Nacional de Trabajadores de la Salud (CONFENATS)
	Confederación Nacional de Funcionarios de Salud Municipalizada (CONFUSAM)
	Confederación Nacional de Sindicatos y Federación de Trabajadores Electrometalúrgicos, Mineros, Automotrices y Ramos Conexos de Chile (CONSFETEMA)
	Confederación Nacional de Pescadores Artesanales de Chile (CONAPACH)
	Confederación de Trabajadores Metalúrgicos de la Industria y Servicios (CONSTRAMET)
	Confederación Nacional de Taxis Colectivos de Chile (CONATACCOCH)
	Federación de Funcionarios de la Universidad de Chile (FENAFUCH)
	Colegio de Profesores de Chile
	Colegio Médico
	Sindicato Interempresas de Trabajadores Oficiales de Naves Especiales y Regionales
	Sindicato de Actores de Chile (SIDARTE)
	Astilleros y Maestranzas de la Armada (ASMAR)
	Sindicato Unitario de Trabajadoras y Trabajadores de Casa Particular (SINDUCAP)
	Sindicatos de Futbolistas Profesionales de Chile (SIFUP)

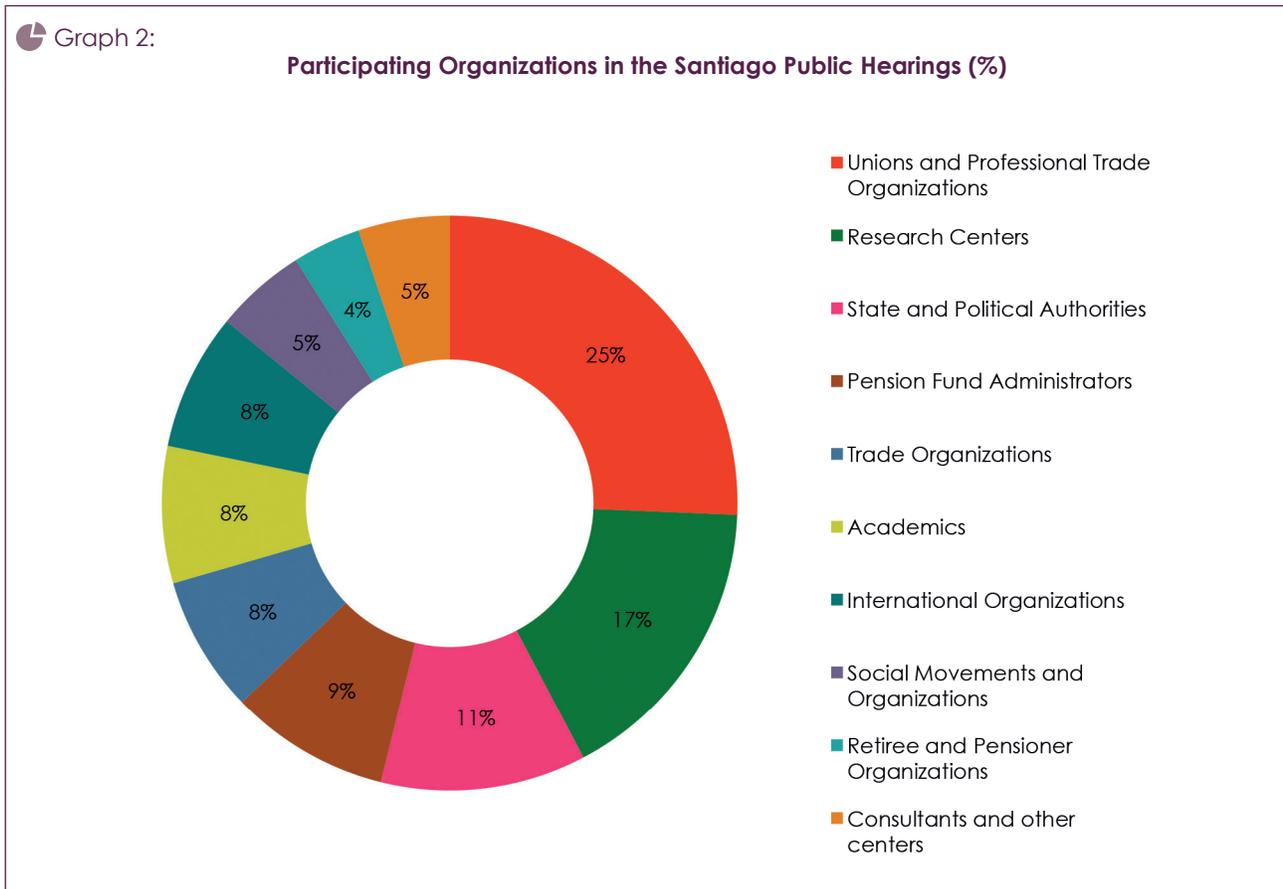
<sup>4</sup> Upon termination of the exposition, recordings of the hearings were uploaded to the website [www.comisionpensiones.cl](http://www.comisionpensiones.cl), in an audiovisual format, as were the documents delivered by each presenter.

<sup>5</sup> Attendees of the Public Hearings were classified according to the following categories: Union Organizations, Research Centers, State and Political Authorities, Pension Fund Administrators, Pensions, Trade Organizations, Academics, International Agencies, Consultants and other Centers, Organizations, and/or social movements and Pensioners Organizations.

<p><b>Research Centers</b></p> 	<p>Instituto de Ciencias Alejandro Lipschutz (ICAL)</p> <p>Sociedad Chilena de Derecho del Trabajo y de la Seguridad Social (SCHDTSS)</p> <p>Fundación SOL</p> <p>Comunidad Mujer</p> <p>Fundación Progresá</p> <p>Centro de Geriatría y Gerontología UC</p> <p>Instituto Libertad</p> <p>Centro de Estudios del Desarrollo (CED)</p> <p>Fundación Chile 21</p> <p>Centro Nacional de Desarrollo Alternativo (CENDA)</p> <p>Fundación Libertad y Desarrollo</p> <p>Fundación Jaime Guzmán</p> <p>Instituto Igualdad</p>
<p><b>State and political authorities</b></p> 	<p>Solange Berstein (Former Superintendent of Pensions)</p> <p>Diputado Juan Luis Castro</p> <p>Juan Arizfía (Former Superintendent of the AFPs)</p> <p>Senador Eugenio Tuma</p> <p>Augusto Iglesias (Former Undersecretary of Social Security)</p> <p>Diputados Daniel Farcas y Gabriel Silber</p> <p>Senadora Lily Pérez</p> <p>Guillermo Larraín (Vice-president of Bancoestado. Former Superintendent of Pensions)</p> <p>Diputado Tucapel Jimenez</p>
<p><b>Pension Fund Administrators</b></p> 	<p>AFP Modelo S.A.</p> <p>AFP CAPITAL S.A.</p> <p>AFP ProVida</p> <p>AFP Habitat S.A.</p> <p>Principal Financial Group</p> <p>AFP Cuprum</p> <p>Asociación de AFP</p>
<p><b>Trade Union Organizations</b></p> 	<p>Asociación Gremial de Cajas de Compensación</p> <p>Asociación de Mutuales A.G.</p> <p>Asociación de Administradoras de Fondos Mutuos de Chile A.G.</p> <p>Asociación de Aseguradores de Chile A.G.</p> <p>Confederación de la Producción y del Comercio (CPC)</p> <p>Asociación Gremial de Asesores Previsionales</p>

<p><b>Academics</b></p> 	<p>José Miguel Cruz</p> <p>Joaquín Vial</p> <p>Salvador Valdés</p> <p>Esteban Calvo</p> <p>Eduardo Fajnzylber</p> <p>Klaus Schmidt-Hebbel Dunker</p>
<p><b>International Organizations</b></p> 	<p>Inter-American Development Bank (IDB)</p> <p>Federación Internacional de Administradoras de Fondos de Pensiones (FIAP)</p> <p>Organización Iberoamericana de Seguridad Social (OISS)</p> <p>Banco de Previsión Social de Uruguay (BPS)</p> <p>Economic Commission for Latin America and the Caribbean (ECLAC)</p> <p>International Labor Organization (ILO)</p>
<p><b>Social movements and organizations</b></p> 	<p>ACUSA AFP</p> <p>Movimiento Ciudadano Aquí la Gente</p> <p>Movimiento por la Diversidad Sexual (MUMS)</p> <p>Coordinadora Nacional NO más AFP</p>
<p><b>Organizations of Pensioners and/or Retirees</b></p> 	<p>Asociación Gremial Nacional de Pensionados y Pensionadas del Sistema de Pensiones Privado de Pensiones de Chile (ANACPEN)</p> <p>Coordinadora Nacional Unitaria de Jubilados, Pensionados y Montepiados de Chile (CUPEMCHI)</p> <p>Asociación de Pensionados, Jubilados y Montepiados de Chile (ASPENJUMCHI)</p>
<p><b>Consultants and other centers</b></p> 	<p>Felices y Forrados</p> <p>ECONSULT</p> <p>ICARE</p> <p>Corporación de Investigación, Estudio y Desarrollo de la Seguridad Social (CIE-DESS)</p>

The following graph provides a summary of participation according to presenter in Public Hearings:



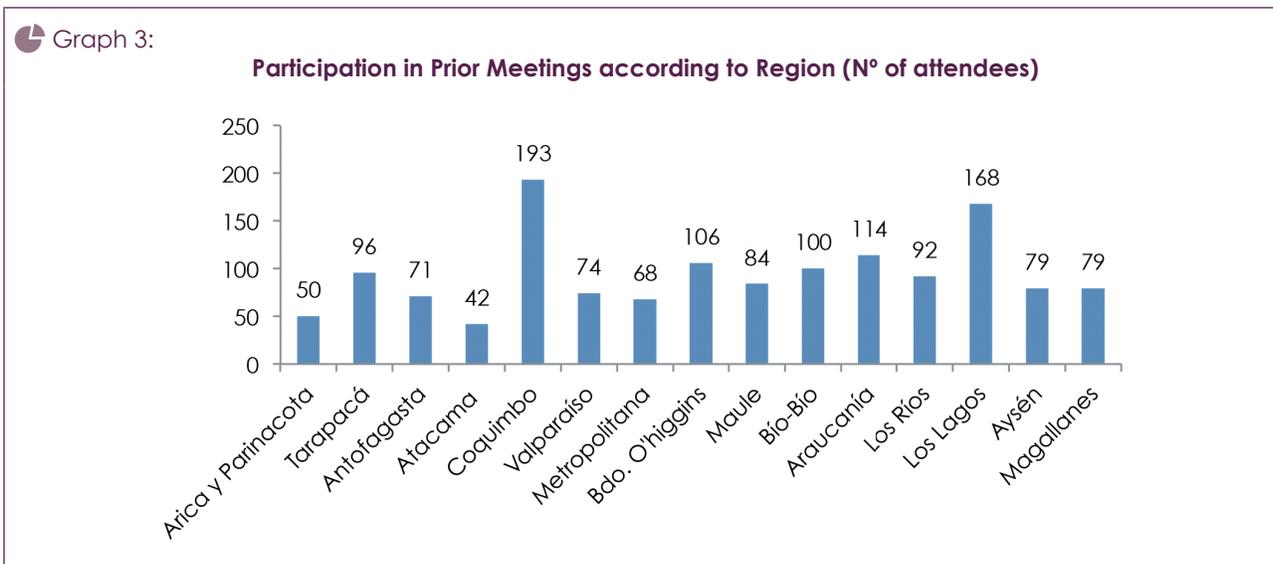
Source: Commission Data

## 5. Regional Citizen Dialogues

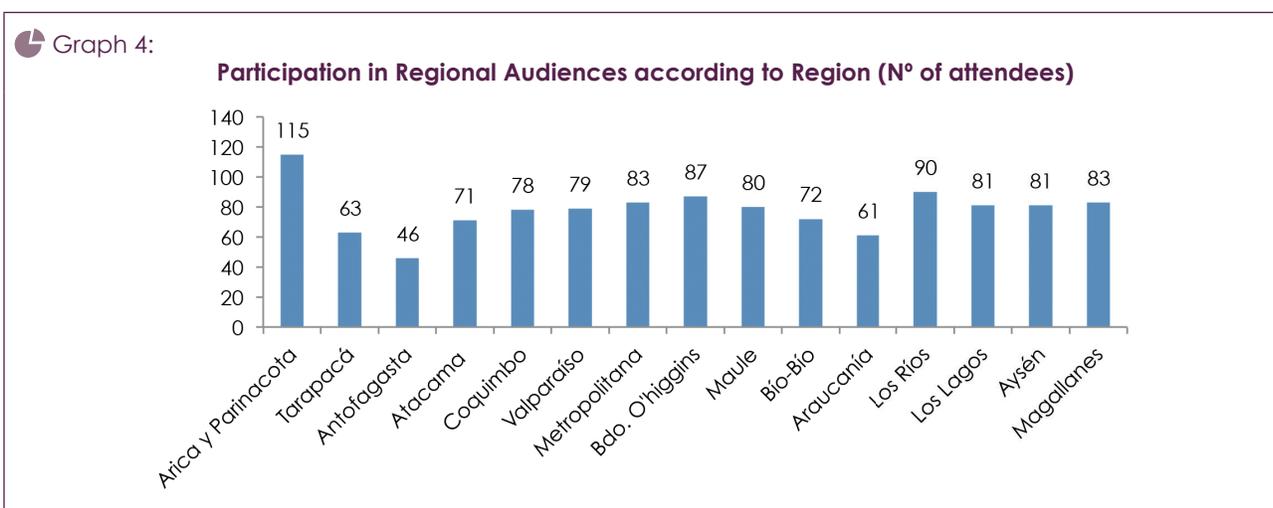
As another one of its mechanisms for citizen participation, the Commission carried out—with the support of the Undersecretary of Social Security—a number of Regional Citizen Dialogues. These dialogues served as a space for conversation between the general public and the Commission in each region of the country. In total, 30 dialogues were held, which were divided into two stages: the first stage consisted of Prior Meetings with wide participation from individuals who were interested in the topic; the second consisted of a Regional Audience with the Commission.

Each one of these instances included a different methodology, which is described in detail in Background Chapter 7.

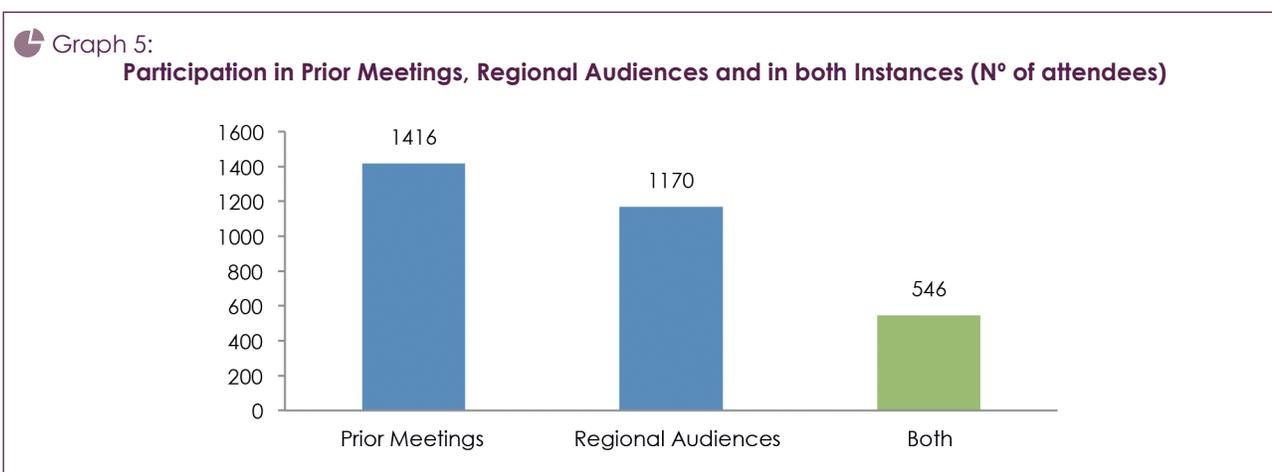
The Prior Meetings were implemented in each of the country's regions, from the 19th of June until the 18th of July of 2014. Audiences with the Commission, in turn, were held between the 22nd of July and the 14th of August of 2014. 1,416 people participated in a total of 15 Prior Meetings, and 1,170 people attended the 15 Regional Audiencias. A total of 546 individuals participated in both meetings. The following graphs provide a summary of participation in these spaces.



Source: Commission Data



Source: Commission Data



Source: Commission Data

## 6. Webpage

One of the main activities carried out within the framework of the Commission's work was the creation and implementation of the webpage ([www.comisionpensiones.cl](http://www.comisionpensiones.cl)), launched in the middle of May. This webpage contains several sections, including: *Presentation; Members; News; Sessions; Hearings; Citizen Dialogues and Documents. Additionally, the page includes a section entitled Write to the Commission.*

This website is used as a mechanism for citizen participation, with which the public can stay informed, and also make inquiries. In total, the Commission received 704 electronic messages and 88 documents. The webpage also registered information regarding the number of downloads from the website during this period, detailed in the following table:

**Table 5: Information Downloads from the Commission**

Type of Documents	Downloads
<b>Public Hearing Presentations</b>	58.674
<b>Prior Meeting Reports</b>	6.776
<b>Acts-Sessions</b>	2.933
<b>Official Documents</b>	4.445
<b>Documents Received via Web</b>	13.422
<b>International Seminar Presentations</b>	1.980

Source: Commission's work based on data collected on June 30, 2015 from the website: [www.comisionpensiones.cl](http://www.comisionpensiones.cl)

The proposals, claims, cases and topics presented in the instances of citizen participation were gathered in a global analysis, in which the principal results of the National Survey carried out by the Commission were included. The topics addressed in the survey were used to categorize and organize the results of the aforementioned results of other instances to serve as a repre-

sentative source of the people's opinion, given its sampling design. This analysis is presented in the first Background Chapter for a Diagnostic of the Pensions System: "A Global Look at the Citizen Participation in the Pensions System" and in Background Chapter 7, "Deepening the instances of Citizen Participation with the Pensions Commission".

## E. Studies requested by the Pension Commission

To complement the evaluation, diagnostic and development work in generating proposals, seven studies were requested by the Commission:

- » **“Systematization of hearings and qualitative studies about social security and perspectives concerning old age”** (Socialis Consultors, 2014). The Commission held a bidding process for a contract to formulate a systematization of the work carried out in the Regional Dialogues. They conducted a qualitative assessment regarding social security strategies for the elderly through 10 focus groups, with the intent of understanding the ways in which distinct groups of people approach their own social security situation as seniors, and how these individuals relate to the knowledge, use, and valuation of the tools afforded by the current Pensions System.
- » **“Survey on the Opinion and Perception of the Chilean Pension System (STATCOM):** The Commission assigned, by way of a bidding process, the implementation of the “Survey on the Opinions and Perceptions of the Chilean Pension System”. The survey’s methodological design was focused on generating quantitative information, complied with criteria of national representativeness and had a sampling error of 4.0% at a confidence level of 95%. The study was administered to a total of 3,696 households between the October 1 and November 6, 2014.
- » **“Study on replacement rates and other aspects related to the pensions system, commissioned by the OECD:** The study analyzes the comparability of replacement rates between countries, published by the OECD in its report “Pensions at a Glance” (2013). It describes the gender gaps in the Pension System of the OECD countries and analyzes situations related to the problems of social security evasion in OECD countries and informality of work.
- » **“Ninoska Damianovic, Calculation of life expectancy in selected districts (exploratory exercise), Document prepared for the Presidential Advisory Commission on the Pension System (2015).** The study reflects the life expectancy at birth of the residents of smaller areas, with the goal of understanding if there is a difference in the average lifespan (level) of the population according to their district of residence, which were selected according to socioeconomic criteria.
- » **“The National Statistics Institute INE, Projections for the Chilean population for the period 2020-2050 (2015).** This study presents projections of the national population for the period 2020-2050, considering three demographic components: fertility, mortality and international migration rates.
- » **“Lydia Lera, Analysis of the survival of elderly adults in Chile based on the National Dependency Survey (2015).** This report analyzes the mortality and survival rates of elderly adults in Chile based on data collected from the National Dependency Survey, conducted in 2009-2010 on a sample of adults 60 years and older.
- » **“Carmelo Mesa-Lago y Fabio Bertranou, Principles of social security and re-reform of pensions in Chile, Report on the Presidential Advisory Commission for the Pension System 2015.** This document analyzes compliance with the conventional principles of social security that arise from the Agreements and Recommendations of the OIT. In each principle of social security four points are explored: a summary of the principle; an abbreviated evaluation of its compliance under the structural pension reform (1981-2008); a similar evaluation concerning the “re-reform” of pensions (2008-2015); and the identification of problems and remaining challenges.

## F. Collaboration of other Public Institutions

For the completion of their work, the Commission members had access to a large volume of information coming from different sources. These included official data from Ministries and Public Services of the State, International Organizations, and databases from different surveys, such as: CASEN, Survey on Social Protection, Survey on Family Budgets, and the National Survey on Dependence in Elderly Adults.

### Internal Operations

The Treasury Department and the Ministry of Labor and Social Security lent their technical support for Commission operations. They have also taken care of the required administrative actions, which were emitted via the Undersecretary of Social Security.

It is worth highlighting that the Commission relied on substantial support from the Undersecretary of Social Security, who offered logistical support in order to ensure that the Commission could operate properly. Similarly, it has contributed in the design, implementation, and analysis of citizen participation, namely Regional Citizen Dialogues that consisted of two stages: Prior Meetings and Hearings with the Commission.

### Gathering of Background Information

The collaboration of ministries, public services, and public organizations that are related to the topic of interest was fundamental. Primarily, this collaboration was crucial to better understanding how certain organizations are addressing such issues as: old age and the aging process of senior citizens, pensions, gender focus, the labor market, and the processing and analysis of the related facts.

- » The Undersecretary of Social Security gave their support via their Research Unit for the various tasks required by the Commission for their work to collect background information for the assessment of the pension system, as well as for the development of the studies that were assigned via a public bidding process.
- » The Superintendence of Pensions collaborated by sharing relevant information regarding the Pension System and its operation, as well as by offering the support of their analysts for the processing of information required by the Commission.
- » The Ministry of the Treasury and Budgets Management also provided relevant support and collaboration by providing background information related to the fiscal costs of the social security system.
- » Additionally, various public organizations and institutions presented and met with the Commission, providing information regarding specific issues related to aging, the pensions system, and its operation:
  - The National Institute of Statistics (INE) presented projections of the population and primary demographic developments in our country to the Commission;
  - The Institute on Social Security (IPS) presented their primary operations and results and institutional challenges;
  - An internal meeting was held with the Presidential Advisory Commission on Social Inclusion of Individuals in Situations of Disability and the Superintendence of Social Security and the National Health Fund;
  - Meetings were held with the National Service for Senior Citizens (SENAMA) with the aim of understanding the main approaches and policies of the government and of the service, which are geared towards elderly adults, using results from the studies that have been conducted and specific characteristics of the interest group;
  - The Commission worked with the National Service for Women (SERNAM) to establish policies with a gender focus, as well as to determine which important issues would be on the Commission's agenda. Furthermore, the interests of SERNAM were established to research specific topics related to the Commission's objectives;
  - The Ministry of Health collaborated by sending background information regarding the health of senior citizens (policies geared to-

wards this interest group, living a healthy life, among other things);

- The Ministry of Social Development, via the Undersecretary of Social Evaluation, provided support, primarily in the joint design and implementation of the work plan for the analysis of various data, variables, and indicators used in the background information for the Commission's assessment (2013 CASEN Survey).
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## G. International Seminar

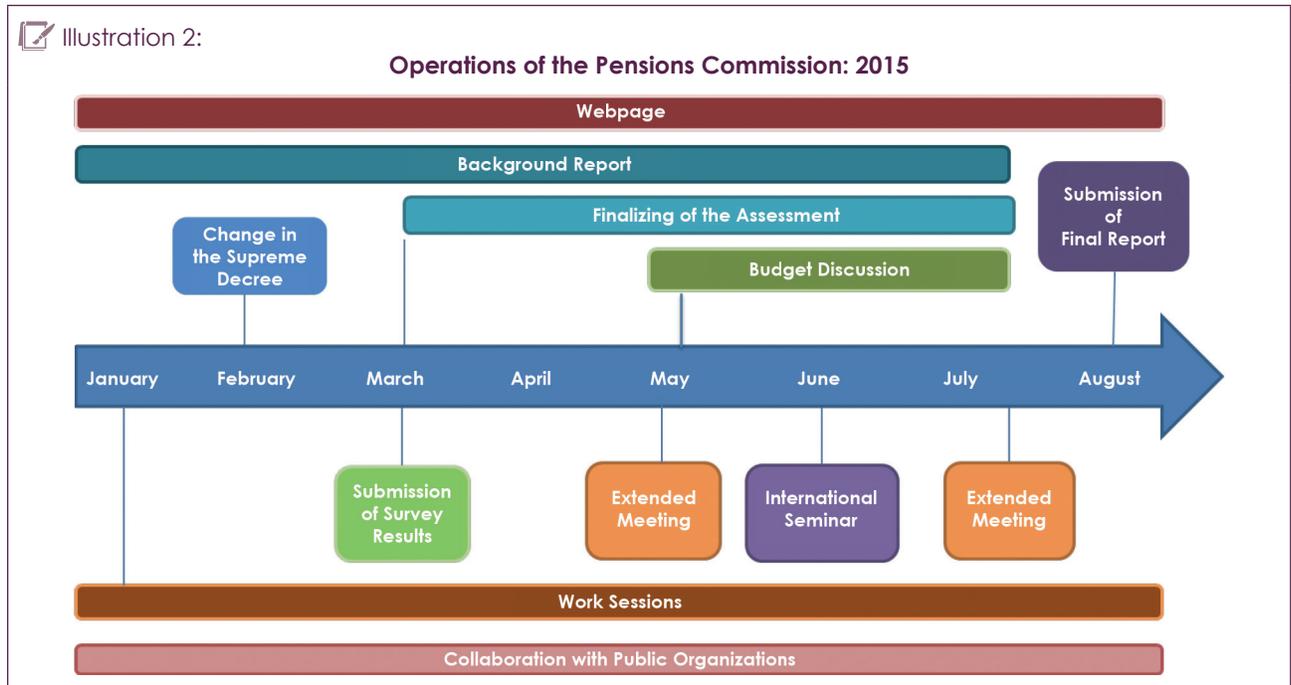
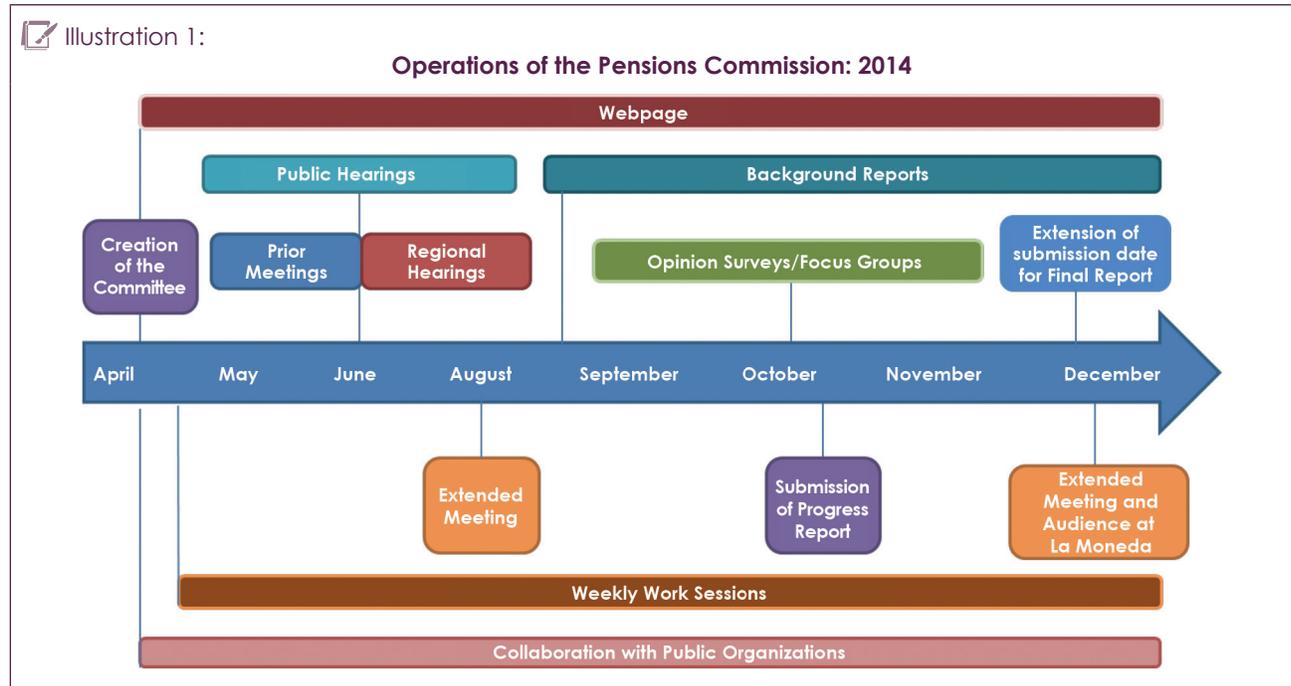
In order to comply with one of the mandates laid out in the DS Number 718 that created the Commission, it organized an international seminar entitled “International Experiences and Tendencies of Pension Systems” on June 16, 2015. This was streamed live and was attended by 300 people.

The seminar took place with the important support of the Inter-American Development Bank (IDB).

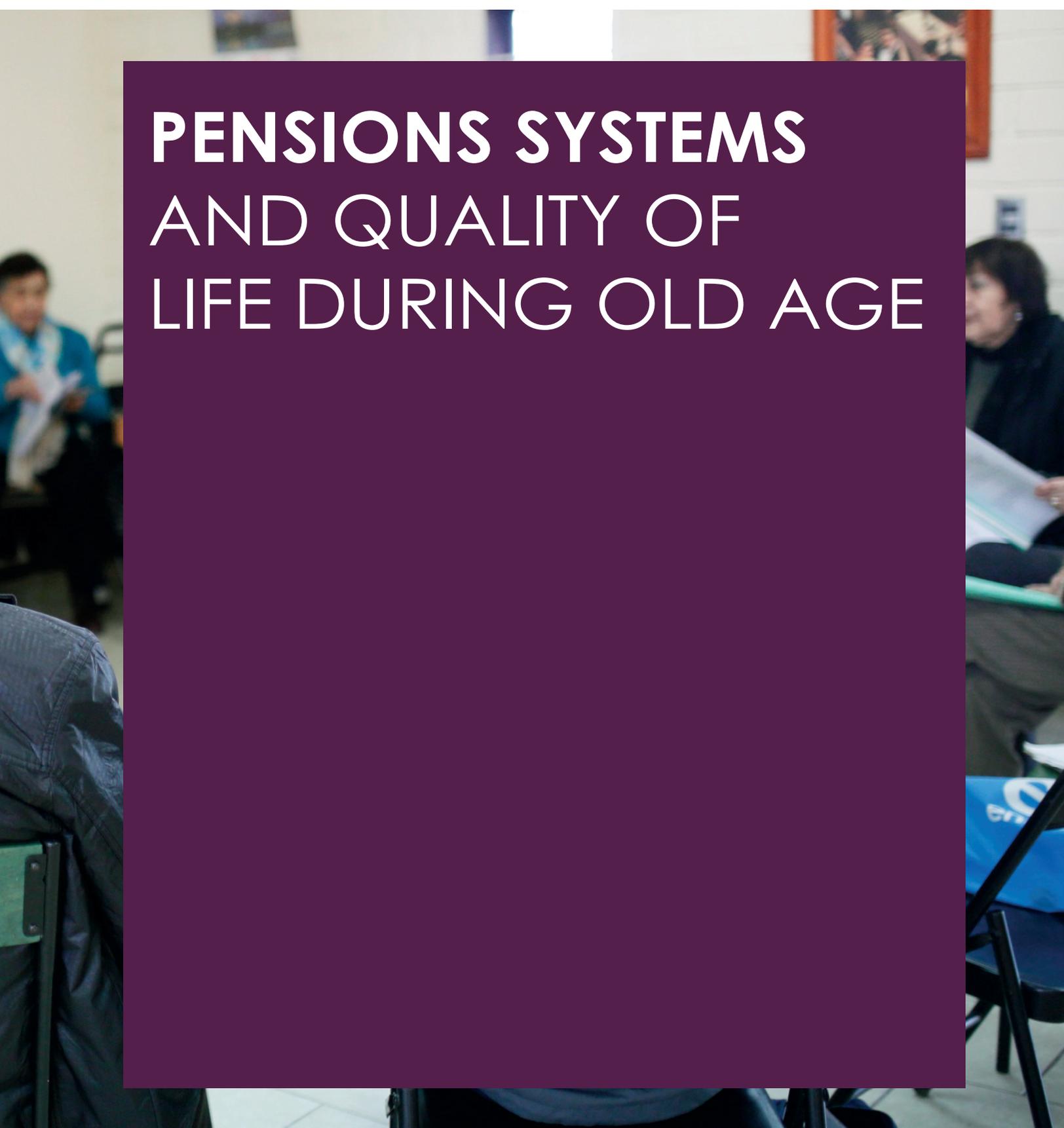
The following people presented at the seminar:

- » Peter Diamond: “Pension Reform.” Emeritus Professor at the Massachusetts Institute of Technology (MIT), 2010 Nobel Prize winner in Economics.
- » Joseph Stiglitz: “Rethinking Old Age Security in the Aftermath of the Global Financial Crisis.” Professor at the University of Columbia. 2001 Nobel Prize winner in Economics.
- » Roberto Ham Chande: “Dependencia en el envejecimiento y expectativas de vida en la población chilena” (“Dependence during the aging process and life expectancy among Chileans”). Demographer, teacher at El Colegio de la Frontera Norte, Mexico.
- » Adolfo Jiménez: “La Seguridad Social en un mundo en cambio” (“Social Security in a changing world”). Economist, Former Secretary General of Social Security at the Spanish Ministry of Labor and Social Security.
- » Isabel Ortiz: “Reformas de los Sistemas de Pensiones: Visión de la OIT a partir de la experiencia internacional” (“Pension System Reforms: the vision of the ILO based on international experience”), Director of the Department of Social Protection within the International Labor Organization (ILO).
- » Carmen Pagés: “Los retos de los sistemas de pensiones en América Latina y su vínculo con el mercado de trabajo: ¿Cómo avanzar?” (“The challenges of the pensions systems in Latin America and its link with the labor market: How to move forward?”). Head of the Labor Market Units within the Inter-American Development Bank.
- » María Nieves Rico: “Desafíos de los sistemas de pensiones y la igualdad de género en un contexto internacional” (“Challenges of the pensions systems and gender equality in an international context”). Director of the Division on Gender Issues in the Economic Commission for Latin America and the Caribbean (CEPAL).

In sum, the different stages of the Commission's work can be understood in the following diagrams:







# PENSIONS SYSTEMS AND QUALITY OF LIFE DURING OLD AGE

### ► III. PENSIONS SYSTEMS AND QUALITY OF LIFE DURING OLD AGE

***“We do not want a country in which being elderly is a synonym for vulnerability or lack of protection, and where retirement, instead of being a time for resting, brings distress and sorrow to individuals”.***

**(President Michele Bachelet, Speech from April 29, 2014)**

Even though aging is a worldwide phenomenon, Chile is one of the countries that has aged the quickest, and it is projected to continue doing so at an even faster pace in the coming decades. This process, which began in the 1960s, is predicted to result, in 2050, in a population of people over 60 that will reach 6.3 million, which will represent 29.5% of the Chilean population, and a doubling of the current population of senior citizens. Moreover, there has been a constant increase in life expectancy from birth. The current life expectancy is 81.6 years for women and 76.5 years for men, and it is predicted to reach 84.7 years in women and 80.8 years in men by the year 2050.

Even though this accelerated process of aging in Chile could be considered to be the result of the success of socio-economic development and public health policy, this aging process will continue to have a wider effects and poses important challenges for public policies that must adapt themselves to a new age structure in its population and to a society that, in general, must change its perceptions and attitudes towards aging.

The most important question to be addressed in this new context is how these newly earned years of life will be lived, in other words, what the quality of life is like today for senior citizens in Chile and what we want this quality of life to be in the future. This challenge must be addressed fully, by assuming responsibility for all of the elements that make up a person's quality of life; biological, psychological, social, and physical elements. The increase in diseases and the reduction of a perception of well-being become an important challenge, certainly within this context. Similarly, the social integration of senior citizens within their environment, their networks, and the availability of help and support becomes a daily reality and a necessity.

However, it is necessary to recognize that the elderly not only demand support, but they also provide it in the following ways; they teach values, habits, concerns, education, and they help younger people to pursue their professional, educational, and recreational goals. For these contributions to be recognized, there must be a change in social attitudes to allows all citizens see the experience of old age as something more positive and inclusive. Lastly, we must acknowledge the importance of a suitable physical environment that meets the physical and subjective needs of the elderly (housing, neighborhoods, and public transportation, among other things). In addition to these tasks, there are the important challenges of both overcoming poverty among the elderly and ensuring that they have a stable income at their disposal during their old age. The two factors contribute to a better quality of life.

In order to deal with all of the dimensions that make up the quality of life for a senior citizen, the following needs to be done: adopt an attitude of critical reflection, develop policies of social protection for seniors, and promote the rights of senior citizens. At the same time, policies should actively seek to build a desirable future for the elderly, and include them as active members in this development. This will require the coordination of policies and programs related to health, housing, transportation, and social bonding and participation, among other things.

Within this context, the pension system has been identified as one of the key elements that must be considered in the country's adaptation to its new demographic reality. Economically, pension systems can provide mechanisms for distributing consumption throughout a person's lifespan, preventing problems when individuals are suddenly faced with the challenges of a much lower income, and guaranteeing that individuals will have sufficient means to face their old age, as well as alleviating poverty and redistributing income and wealth (Barr and Diamond, 2012).

Nevertheless, pension systems also determine and reflect, at least partially, the way in which senior citizens are integrated into society. The design and operations of pension systems allows us to understand how a society values their senior

citizens and the contribution that they make on a daily basis as well as the contribution they made to society during their professional careers. With this idea in mind, the 2006 Report of the Presidential Advisory Commission for Pensions Reform explained that in developed countries the solution for ensuring that seniors could be as autonomous as possible is shifting from being an individual responsibility to being the responsibility of the society as a whole.

The Commission believes that the analysis of social security principles that has emerged from the Conventions and Recommendations of the ILO (as well as from its publications) and from the information from the ISSA, the CISS, and the OISS offers a perspective with which to analyze a pension system's real capacity to fulfill its objectives of poverty alleviation and the consumption smoothing over the course of an individual's life. As identified by Mesa-Lago and Bertranou (2015)<sup>6</sup> the principles of social security are: (a) social dialogue, (b) universal coverage, (c) uniform treatment, (d) social solidarity, (e) gender equality, (f) sufficient funds, (g) reasonable administrative cost and efficiency, (h) social participation in management, (i) role of the State and supervision, and (j) financial sustainability.

In the various instances of citizen participation, citizens demanded that the principles of social security be used as parameters for evaluating the performance of pension systems and as guiding elements in their proposals to improve these systems<sup>7</sup>. Taking this demand (which was expressed by a large number of different citizens and organizations that participated) into account turns out to be essential in a context in which the Chilean Pension System suffers from a lack of legitimacy<sup>8</sup>. This lack of legitimacy comes from the flaws within the system itself, which presents a

large component of uncertainty and insecurity in the foundations of the system, and legitimacy is essential for the proper operation of a Pension System over the long-term.

This report, as mandated by the President of the Republic, Michele Bachelet, when she created the 24-member Commission, seeks to contribute to the search for the answer to the uncertainties and expectations of Chilean citizens regarding their pensions system. The Commission has taken responsibility for this task and describes the results of its process in this document and its multiple appendices, all of which review the features, flaws, and challenges of the system, and creates proposals that are focused on solving the primary flaws in the system.

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<sup>6</sup> The Commission requested that two of its international members prepare a study to assess the extent to which the Chilean Pension System complies with the principles of social security. This report, Mesa-Lago y Bertranou (2015), is available at the Commission's website.

<sup>7</sup> The definition of social security understood by the majority of the indices is the definition that is used in Agreement 102 of the ILO, where social security is understood as a human and social right that must be guaranteed by the State.

<sup>8</sup> This topic is approached in the section V as well as in the chapters of backgrounds of the present report.

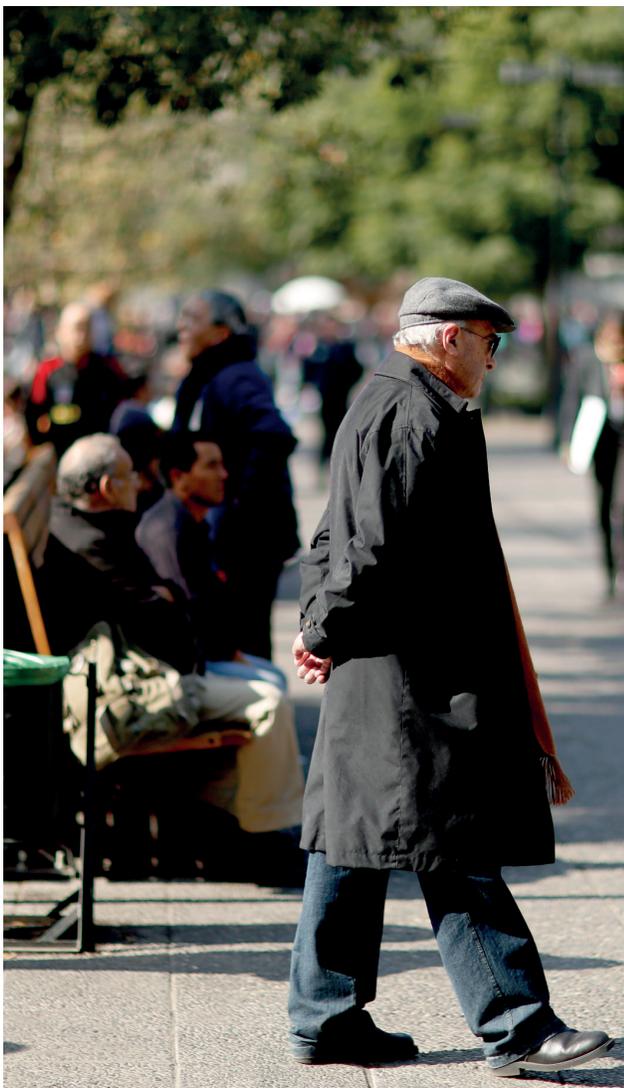


# DESCRIPTION OF THE CHILEAN PENSION SYSTEM

## ▶ IV. DESCRIPTION OF THE CHILEAN PENSION SYSTEM

### A. The situation before 1981

Chile pioneered the development of Social Security in Latin America, with the first comprehensive regulatory system in 1924 (Mesa-Lago, 1978; Wagner, 1983; Arellano, 1988). This system, which existed until 1981, evolved by responding to the needs of employee organizations and professional groups in a piecemeal and inorganic way, incorporating dependent workers into a system of semi-public social security providers. These institutions were sustained by compulsory contributions made by workers and employers (including the State as an employer), which guaranteed that the beneficiary would receive health care, a disability pension and retirement pension.



The political economy of this process continued until the end of the seventies, when the Chilean system had more than 30 social security providers and around 150 different types of pension schemes, with legal regulations that were distributed across more than 600 legal bodies. The system was criticized for being segmented, without portable rights that contributors could carry from one pension provider to another, because each provider administered a different set of risks (for health, pensions, disability insurance, survivors insurance, and work-related accidents or illnesses) with a single contribution rate. With regards to pensions, the system could be characterized as a pay-as-you-go system that offered benefits that were both defined and also heterogeneous according to the type of pension scheme that the affiliate had, and that, over the years, established a certain continuity between the various pension providers<sup>9</sup>.

By 1980, the system paid out more than a million pensions to 1.7 million registered taxpayers, covering close to 75% of the employed people in Chile. The requirements of each pension system were different, including different legal retirement ages or dissimilar thresholds for how long affiliates had to contribute in order to receive benefits<sup>10</sup>. Also, the contribution rates were much higher than they are now<sup>11</sup> (for example, in 1973, the pen-

<sup>9</sup> Each provider offered different benefits to its affiliates and these benefits varied with respect to coverage, the contribution amount, and expected pension at retirement, etc. In 1972, the Private Employees Fund, the Fund for Public Employees, and Workers Insurance Fund—later called Social Security Service—covered 63% of the country's total contributors. The Private Employees Fund and the Fund for Public Employees worked similarly. The funds were gathered from individual contributions and employer contributions, in the case of the Fund for Private Employees, and from state contributions in the case the Fund for Public Employees. The retirement pension was paid out after a certain number of years of service or at a certain age—the retirement ages varied between 55 and 65 years (Arellano, 1988).

<sup>10</sup> The retirement ages for old age pensions varied between 55 and 65 years old, but there were "seniority pensions" (except in the Social Security Service) that delivered pensions, depending on the provider, for workers that had between 13-35 years of service or contributions.

<sup>11</sup> The contribution rate was not exclusively for the payment of pensions, it also covered other risks such as medical care and/or disability insurance, or deductible loans from each employee's account (the Worker's Insurance guaranteed health care for all of their affiliates, but the Fund for Private Employees did not).

sion provider “Social Security Service” required an employee contribution of 9.5 % and employer contribution of 40.4 % of taxable income; the “Private Employee Fund” required an employee contribution of 14.6% and an employer contribution of 44.4% and the “Public Employees Fund” required an employee contribution of 18.8% and an employer contribution of 7%) (Arellano, 1988).

In the 1960s and up until 1973, there were several reports published that identified the main weaknesses of the system, its distortions and unequal privileges (the Klein- Saks Mission, 1955; Prat Report, 1960), but the state failed to implement the reports' recommendations due to a lack of the necessary political consensus (Arellano, 1988; Mesa -Lago, 1994; Arenas de Mesa, 2000).

In the early years of the military dictatorship, before the 1981 reform, the state made significant changes to the so-called “old pension system”<sup>12</sup>. For example, in 1974, the state streamlined the minimum pensions across different pension providers and systematically reduced contributions. In 1979, it standardized the age requirements for retirement (this reform established the retirement age at 65 for men and 60 for women) and standardized the system of adjustments, among other modifications.

## B. The 1981 Reform

In May of 1981<sup>13</sup>, under the sway of a pro-market doctrine on the issues of health insurance and social security savings, the state passed Decree Law 3500, which created a new pension system. This system was based on individual capitalization<sup>14</sup>, with defined and mandatory contributions from dependent workers, who were registered as new affiliates, and the system made exceptions for the Police and Armed Forces, who remained in their own system (Benavides & Jones, 2012). The pension providers for the National Armed Forces and the Police (CAPREDENA y DIPRECA) were not included in the 1981 Reform and currently still operate under a pension system for which the State finances 91% and the remaining 9% is financed by the taxation of the pensions from both active and passive personnel.

Under this system, pension contributions are made by the employee, with the exception of those relating to insurance against work-related accidents and illnesses, which are still paid by the employer<sup>15</sup>. Contribution rates are set at 10 % of the employee's taxable income, which is paid into an individual capitalization account, and affiliates also pay a contribution that covers survival and disability insurance and a fee to the AFP<sup>16</sup>.

The pension funds are administered by private entities whose only purpose is to administer these funds, called Pension Fund Administrators (hereinafter “AFPs”). These entities are subject

13 Decree Law No. 3500 created the system of individual capitalization and the Superintendence of Pensions; Decree Law No. 3.501 established the new system of pension contributions; Decree Law No. 3.502 created the Instituto de Normalización Previsional (Institute of Social Security Standardization). All these decrees were ordered in November 1980. The reform was announced in 1980 and came into force in 1981.

14 The reform implemented departed from the proposals from the Klein- Saks reports, the Prat Report and the preliminary draft pension reform of 1975. The preliminary reform of 1975 sought to maintain a strong role for the state and a pay-as-you-go scheme, based on a streamlined model of a single system with common standards.

15 Which has changed somewhat at the date of the publishing of this report, with Unemployment Insurance, Disability Insurance and Survival Insurance (SIS), and a contribution of 2% from employers of workers who work in “heavy duty” jobs.

16 This contribution rate is intended to cover only the payment of pensions. The affiliate must also pay an additional fee for the fund's administration and insurance for disability and death.

12 Pension schemes that existed prior to the structural reform of 1980 are referred to as the “old pension system”.

to regulation by the state. The AFPs charge their affiliates fees for the funds' operation, including administrative costs, insurance premiums and disability insurance. This additional contribution, which goes to pay the fees, rose to be 4.87 percent of affiliate's taxable income (in 1983), then tapered slowly downward (in 1984-1992) to stabilize around 3 percent (1993-1997). Then it began to decline rapidly to levels around 2.5 percent of taxable income, where it remained until the 2008 reform (Law 20255) created a bidding mechanism for new affiliates. Today, according to the AFPs, the additional contribution that goes to pay AFP fees represents between 0.47 and 1.54 percent of affiliates' taxable income. In this comparison we must remember that, as of the 2008 reform, the employer is responsible for financing the contribution for disability and survival insurance.

Since the 1981 Reform, people who have joined the AFP system have experienced a decrease in the total contribution rates (between 13% and 20% of taxable income) which resulted in an increase in the net income, and acted as an incentive for changing to the new system<sup>17</sup>. Nowadays, the contributions made by an affiliate to the former system are higher in comparison to the ones made by an affiliate to the current pension system—including old-age, survivals and work accidents—and vary between 7.6 and 11.8 percentage points of net income<sup>18</sup>.

AFPs collect contributions, manage individual accounts, and invest pension funds in assets in

17 If one considers that the total contribution in 1981 for an affiliate to the AFP system that included health, fees and disability and survival insurance, did not exceed 20% and, on the other hand, the contribution rates under the old system in 1980 (which had decreased in relation to previous years) were 33.2% of taxable income (7.25% of the worker and 25.95% of the employer) in the "Social Security Service"; 41.04% in the case of "Private Employees Fund" (12.33% of the worker and 28.71% of the employer); and 32.5% in the case of "Public Employees Fund" (18.5% of worker and 14% of the employer).

18 Since the IPS collects seven percent from affiliates of FONASA, the equivalent pensions and insurance and disability rate would amount to: between 18.84 and 19.79 percent for affiliates of the Social Security Service, between 21.84 and 22.79 percent of those affiliated to the Private Employee Fund, between 18.62 and 19.57 of affiliates of and those who were participants in the Public Employees Fund. In short, if we assume that the gross rate of the AFP system is now 11 percent, the gross rate of the old regime was higher, between 7.62 and 11.79 percentage points of taxable income.

the domestic capitals market and abroad in instruments with predetermined limits. Affiliates can change their choice of AFP. Before the 2008 reform, the state modified the system to authorize each AFP to manage five different funds (multifunds) from which affiliates could choose according to their preferred risk profile.

In this system, the objective of poverty relief is addressed through two benefits: minimum pensions established by law (for those have contributed for 20 years) and a Social Assistance Pension (PASIS), which is not a right but is rather assigned according to the targeting criteria subject to budgetary restrictions. Both are financed outside of the system, through taxes, and are included in the allocations of the Budget Law.

The state has financed all the costs associated with the transition of the pension system. It must cover the deficit generated by the former pension providers (that deficit gets passed onto the Institute for Social Security Standardization (INP)), pay a Recognition Bond that recognizes contributions made under the old system, and finance the guarantee of minimum pensions and social assistance pensions. The present value of these payments was estimated for 1981 at 136 % of GDP, and has come to represent annual state subsidies of nearly 5 percent of GDP in 1984, not including the cost of the pension of the Armed Forces. While the costs have diminished, they have not yet been paid off (for more details, see Section D below).

The legal retirement age remains 60 years old for women and 65 for men, although it is possible to take one's pension early if other requirements are fulfilled, or to remain working and postpone taking one's pension until after these ages.

Affiliates have the option to choose the type of pension they prefer when they retire (provided they have a sufficient amount accumulated in their account for that type of pension). They may also opt for a programmed withdrawal (paid by the AFP), and thereby keep ownership of the funds. They may opt for an annuity (the fund is transferred to an insurance company) or they may choose other methods that combine these options. In cases where the amount of funds in their account is not sufficient, the affiliate retires under the programmed withdrawal mode by default.

During an affiliate's "active phase" in which they are working and contributing to the system, the risks associated with the labor market are borne by the affiliate, who also bears the risks of the investments associated with individual capitalization funds. In the "passive stage", when the affiliate is receiving a pension, if they opt for an annuity they face the risks of longevity and of the investments of the relevant funds<sup>19</sup>; In contrast, if an affiliate chooses to make a programmed withdrawal, they assume the risk of investment funds and of survival<sup>20</sup>.

Modifications of Decree Law 3.500 after 1981 include: the loosening of the regulation on the investment of pension funds, voluntary pension savings, contributions for heavy work<sup>21</sup>, the decrease in the reserves from 5% to 1%, the elimination of the Reserve Fund for Fluctuation of Returns and Cash Reserves<sup>22</sup> (which reached 5% of the pension fund), the introduction of multi-funds (in 2002) and the introduction of electronic consultation system that pension amount offers (SCOMP)<sup>23</sup>.

As part of a broader social security net, the pension system implemented in 1981 does not guarantee benefits, but, rather, it gives the affiliate a choice between different financing options to mitigate the risks associated with having an individual savings account from which they then receive benefits when they retire. This contract depends on the affiliate's options at the moment of their retirement, when demographic and financial factors must be considered. The only

certainty for the affiliate is in the mandatory contribution into the savings account, assuming that the affiliate has stable, dependent employment. The pension administration industry and related insurance companies operate without perfect competition in markets that are characterized by strong asymmetries of information at the expense of the affiliate. State regulations have not been able to fully resolve these issues and there is still a real need for adequate regulation.

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19 Pensions that are taken as Annuities, in contrast to pensions taken with the Programmed Withdrawal modality, place the risk of insolvency on affiliates, because only AFPs keep the funds that they administer separate from their own resources.

20 In other modalities, a combination of the above occurs. For example, in the case of Temporary Annuity with Deferred Life Annuity, the pensioner assumes the risk of investment of the temporary annuity while the part of the deferred annuity covers the costs of investment and survival.

21 Law 19.404 on heavy work, from August 21st 1995, sets a contribution and an additional complement of 2% from taxable income for the employer and the worker, respectively (2% contribution from the worker, and 2% complement from the employer)

22 For a description of the Reserve Fund for Fluctuation of Returns and Cash Reserves see Background Chapter 3 of the Final Report.

23 For a detailed description of the multi-fund mechanism and SCOMP, see Background Chapter 3 of the Final Report.

## C. The 2008 Pension Reform

The Advisory Council on Pension Reform (the “Marcel Commission”) began in 2006 and culminated in the enactment of Law 20.255 of 2008. The 2008 pension reform has been the most substantive amendment of DL 3.500 thus far. Its main features were<sup>24</sup>:

- a) It incorporated a Solidarity Pension System into the existing system of individual capitalization accounts, in order to provide old age and disability benefits. This included the Basic Solidarity Pension (hereinafter “PBS”<sup>25</sup>), a benefit for people that do not have the right to a pension under any other pension scheme, and the “Top-Up Welfare Complement” (hereinafter “APS”). In the case of old-age benefits, the APS is a monthly amount that supplements affiliates’ self-financed pensions when those pensions amount to less than the Maximum Pension with Solidarity Contribution (hereinafter “PMAS”).

In order to access the benefits of the new Solidarity Pillar, people must be in a household that is within the poorest 60% of the population and prove residence in Chile for a period of no less than 20 years<sup>26</sup>. In the case of old age benefits, people are also required to be at least 65 years old. In the case of disability benefits, on the other hand, people must be between 18 and 65 years old and have been declared disabled by the Medical Boards of the Pensions.

The Solidarity Pension System is financed only with state resources. In March 2015, the number of benefits delivered through Solidarity Pension System surpassed 1.3 million, with a fiscal cost equivalent to 0.7 % of GDP, according to DIPRES.

- b) The reform instituted a bidding process for the portfolio of new affiliates—for two years—as a way to introduce greater competition between AFPs and to mitigate the lack of sensitivity of affiliates to variables such as profitability and fees. The resulting reduction in fees

applies only to the affiliates of the AFP that wins the bidding process and for all of the affiliates that then switch to that AFP.

- c) The reform introduced a contribution for disability and survival insurance to be paid by the employer, which has decreased the cost of the insurance while maintaining the benefits.
- d) The reform established mandatory contributions for self-employed workers who charge hourly fees. These mandatory contributions would be imposed gradually, until 2015, when they would be required to contribute 10% of their taxable income<sup>27</sup>.
- e) The reform introduced the payment of a bonus for each live birth (including of adopted children) for all women affiliated with the AFP system, which could be accessed when the woman reached 65 (the “Grant per Child”)<sup>28</sup>.
- f) The reform also included other policies, such as the introduction of Collective Voluntary Pension Savings (APVC), the Pension Subsidy for young workers, the creation of the Fund for Welfare Education, and economic compensation for social security in cases of annulment or divorce, among others<sup>29</sup>.
- g) The reform created instances of social and technical participation through the establishment of a User Committee, the Consultative Council on Social Security and the Technical Investment Council<sup>30</sup>.

- h) The reform strengthened state participation by creating the Superintendence of Pensions, which replaced the Superintendence of AFP and the Social Security Institute (hereinafter “IPS”)<sup>31</sup>, replacing the Institute of Welfare Standardization. It also strengthened the powers of the Undersecretary of Social Security.

24 See Background Chapter 2 of the Final Report.

25 The amount of the PBS of old age is currently \$89.764 and the PMAS is \$291.778, and these amounts are adjusted annually for inflation.

26 The residency requirement is 20 years, continuous or intermittent, counted from when the petitioner has turned 20 years old.

27 According to Title IV of Law No. 20.255.

28 For a description of the benefit, see Background Chapter 4 of the Final Report.

29 For a description of these mechanisms, see Background Chapter 2 of the Final Report.

30 For a description of the User Committee, the Consultative Council on Social Security and the Technical Investment Council, see Background Chapter 2 of the Final Report.

31 The Social Security Institute takes as an aim the administration of the solidarity pensions system and pension schemes previously administered by the Institute of Normalization Previsional.

## D. Characteristics of the Current Pension System in Chile

Since the 2008 reform, the current Pension System could be characterized as a system that integrates a “passive stage” tax-financed solidarity pillar<sup>32</sup> with an individual accounts system financed by contributions. Unlike what was originally established in DL 3.500, the Solidarity Pillar (through the PBS and APS) establishes rights by ensuring minimum levels of benefits for the most vulnerable populations and significantly increases coverage of the social security net. Because of the PBS (with the old minimum and welfare pensions, PASIS), coverage in the first quintile increased. Coverage of women 60 years old and older increased from 50% in 2006 to 63% in 2009. In the same quintile, coverage of men 65 and older increased from 39% to 47% in the same period, according CASEN 2006 and 2009. In terms of the adequacy of pension amounts, the amount of benefits also increased. PASIS beneficiaries received an amount of \$ 48,000 per month, while the PBS began with the amount of \$ 60,000 and has now risen to \$ 89.764.

The benefits of Solidarity Pillar, moreover, are integrated with self-financed benefits from the individual accounts to form a Solidarity Pension Payment (APS), which is awarded in a decreasing curve relative to the amount saved in a pension account, under the assumption that this declining relationship will improve incentives to contribute.

The current system, therefore, includes self-financed benefits as well subsidized old-age benefits, disability benefits and survival benefits that together allow to smooth consumption and alleviate poverty in old age.

The contribution rate to the pension fund (10%) was not changed by the 2008 reform and is relatively low compared to the other countries' current contribution rates<sup>33</sup>, as those present with the former system. There is no employer contribution

32 The state offers subsidies during an affiliate's “active” stage, to incentivize savings, such as a maternity bonus, a contract subsidy and subsidies for young contributors.

33 The average contribution rate across OECD countries is 19.6%. In the majority of the OECD countries, 57.1% of old age contributions are the responsibility of the employer and 42.9% are the responsibility of the employee.

to the pension fund except for those jobs where the work is classified as “heavy” and in the case of Disability and Survival Insurance (SIS), which is financed by the employers during the active working life of affiliates.<sup>34</sup>

The system maintains the benefits self-funded pension modalities established in DL 3.500.

The system continues to exclude the Armed Forces and the Police, whose system is financed from taxation and state contributions.

The current regulatory framework of the system includes the Superintendence of Pensions and the Superintendence of Securities and Insurance, as well as the design and evaluation of policies by the Undersecretary for Social Security. Private in nature, AFPs must work with the IPS, which administers, among other things, the benefits of the Solidarity Pension System. The regulatory framework also includes the Technical Investment Council, the Consultative Council on Social Security, technical institutions, and the User Commission. The Users' Commission evaluates and participates in the system, and is part of an integrated system of workers' representatives, pensioners, public institutions, AFPs and academic institutions.<sup>35</sup>

### Fiscal Commitments

With respect to sustainability, we separate the costs of the 1981 transition from the additional costs of the 2008 reform, particularly with regards with the Solidary Pension System.

The cost of the transition initiated in 1981 (from recognition bonds, the operational deficit, and the state-guaranteed minimum pension) reached almost 5% of GDP in 1984 annually. This expenditure has been declining as the state has paid most of costs associated with changing the system. The cost of the transition (we estimate the present value as the equivalent of 136% of the GDP in 1981) has been taken on by the state through a combination of tax reforms, spending cuts and debt issuance. The spending to cover the operational deficit reached 1.6% of GDP in

34 Additionally, the 2008 reform made the employer responsible for financing the contribution for disability and survival insurance.

35 For a description of each of these institutions, see Background Chapter 2 of the Final Report.

2012 (Public Finances Report 2014). Indeed, it is expected that by 2025, the cost of the transition will decrease to 1% of GDP, according to DIPRES projections. The total cost of the 1981 structural reform is projected at 2.7% of GDP in 2025 and will not disappear until 2050, taking 70 years to pay off, in contrast to original projections (Mesa-Lago & Bertranou, 2015).

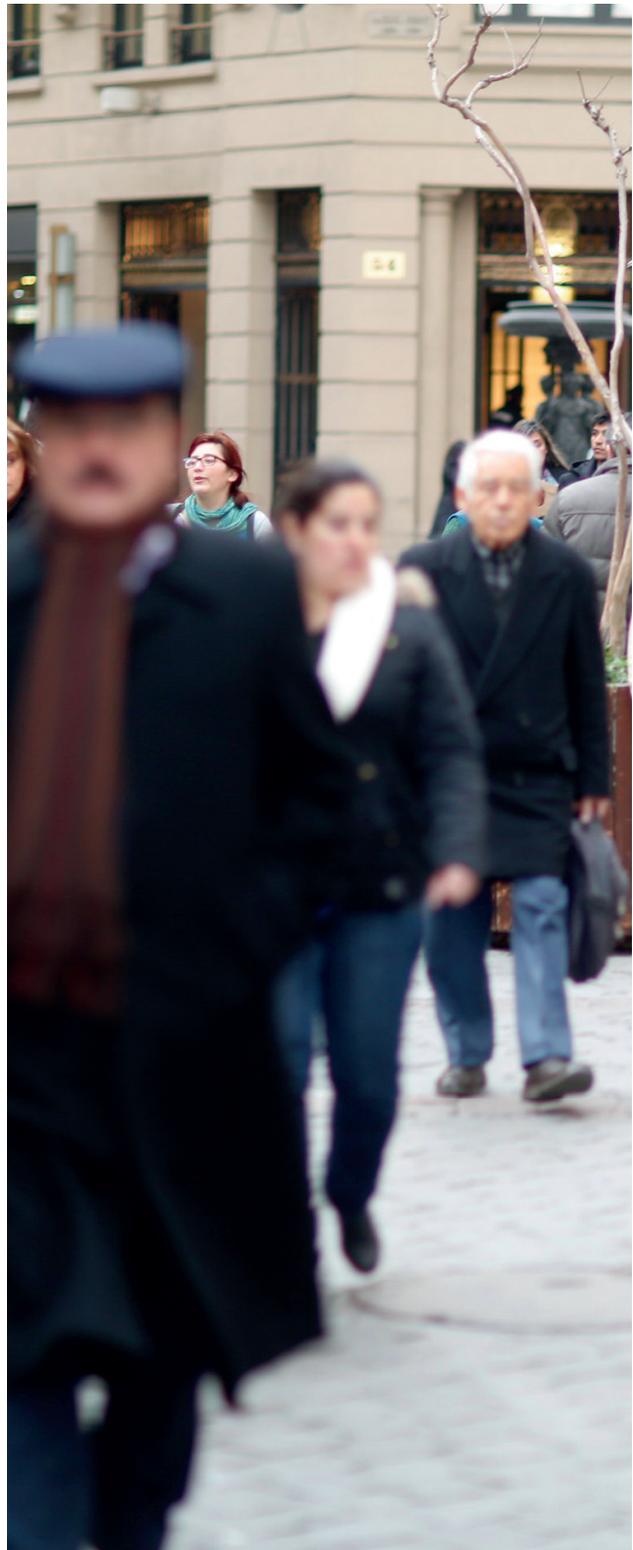
The fiscal discipline required by the Chilean transition suggests two conclusions about the process as compared to other international experiences of transitions from a pay-as-you-go system to an individual capitalization system. First, the fact that the fiscal savings required to accommodate the costs came to represent about 5 % of GDP and is still being used to pay off the transition today means that the decision to take on this burden is unparalleled in democratic periods in the debates over the Budget Law in Chile. Second, the previous fiscal savings allowed the State to avoid displacing (through debt securities) alternative investments for pension funds, which, in turn, allowed the capital market to develop.

This is why this experience is unique, and responds to a particular situation and why the burden of its financing fell both on the generation that experienced the transition and on the generations that still experience the effects of fiscal adjustment, even as they also self-fund their pension.

The costs associated with the current system arising from the 2008 reform are calculated separately. The explicit guarantees and financing from the Budget Law of each year has allowed the state to sustainably finance the Pension Reform of 2008, with actual spending even lower than projected. In 2013, spending on the Solidarity Pension System accounted for 0.7% of GDP, of which 61.2% is concentrated in paying for the PBS and 38.8% goes to the APS, according to DIPRES data.

For their part, the social security system of the Armed Forces, consists of a National Defense Welfare Fund (CAPREDENA) and the Chilean Police Forces Welfare Institute (DIPRECA), and incurred costs equivalent to 0.9% of GDP in 2012. The solidarity of the current pension system is exogenous, in the sense that it comes entirely from the state (there is no solidarity or cross-subsidies between contributors or affiliates, nor are there intergenerational transfers). Nevertheless, indi-

rectly, State solidarity is produced inside a generation and between generations, if one considers that most of the state resources come from the income tax (43%) and from VAT (45%).









# EVALUATION OF THE CURRENT CHILEAN PENSION SYSTEM

## ► V. EVALUATION OF THE CURRENT CHILEAN PENSION SYSTEM

### A. Context in which the current pension system operates

Pension systems are not neutral with respect to the context in which they operate, and this influences both the evaluation of the system as well as the quality of pensions that the individual capitalization system provides.

The Commission considered it important to examine the current pension system, taking into account some relevant aspects of the Chilean context. It focused on three criteria: (i) variables of the context itself which influence the balance of accumulated pension funds and the adequacy of benefits (ii) conditions of the industry and of institutions in relation to efficiency and social justice, which also influence the pension amount granted by the system, and (iii) the legitimacy of the system in the eyes of citizens and citizen behavior, which reveals people's understanding of the system and their perception of it.

In relation to the context itself, we considered four fundamental factors:

- a. Demographics, which determine both the potential generators of taxable income, and the number of elderly dependents.
- b. The quality of life in old age, which determines the standard of consumption that one wishes to transfer the elderly.
- c. Household composition and the distribution of roles in household, which largely determines the welfare of the adults that live in those households, and whether some of those adults can offer time in exchange for taxable income,
- d. The labor market, which determines the level and distribution of taxable income that may be spent or transferred, which is fundamental for the accumulation of funds in workers' individual capitalization accounts.
- e. A gender perspective, which requires us to consider the diverse demographic, economic and sociocultural factors that are tightly linked to the pension systems and that directly influence the observed gender gap.

In relation to the quality of the benefits, the results will depend on how efficiently the institutions both transfer present consumption to future consumption and alleviate poverty. It is therefore necessary to analyze the role of the industry of pension fund administrators and of other institutions regarding:

- a. The efficiency with which the AFPs allocate resources to transfer present consumption into future consumption; and
- b. The justice and fairness with which they transfer current consumption to future consumption; ensuring criteria that examines both vertical and horizontal equality.

Regarding the legitimacy of the system and the behavior of citizens in regards to the system, the Commission considered it essential to contemplate:

- a. The degree of understanding of the citizens regarding parameters and features relevant to the system.
- b. Public perception of the current system

Each of these three groups of factors is examined separately.

### 1. Accelerated aging and the quality of life of senior citizens

Over the past 60 years, Chile has experienced major changes in its population structure<sup>36</sup>. Although these changes are the successful result of technological advances, medical and public health policies, they also represent a challenge for our pension system, because they: (a) reveal a shift regarding potential sustainability—particularly with regards to the sustainability between those who work and the dependent population; (b) show an increase in population which will require support and care, particularly with respect to pensions; and (c) allow us to estimate the period of time which pensions will have to cover in the future.

<sup>36</sup> For more details, see Background Chapter 2 of the Final Report.

Since the 1960s there has been a steady decline in fertility and mortality rates, which has changed the age structure of the population, decreasing the percentage of young people and concentrating the percentage increase of people in older ages. The result is an accelerated aging process: according to the INE, between 1990 and 2015 the population aged 60 years old and older increased from 9% to 14.9 % of the total population. This proportion is expected to double by 2050, becoming 29.5 % of the population. In just 35 years, therefore, the number of people over 60 will go from a total of 2.7 million people to 6.3 million.

This trend is also reflected in the ratio of working-age people relative to the elderly, according to projections by INE. For example, while in Chile in 2010 there were nearly 5 people of working age (15-59 years old) for every person aged 60 or older, this ratio will drop to 1.8 in 2050. This trend, coupled with the permanent increase in life expectancy at birth—which is currently at 81.6 years old for women and 76.5 years old for men, has made Chile a rapidly aging country.

The achievement of living longer should be analyzed in light of the quality of life of these later years. With respect to quality of life, we have measured health and quality of life through various elements: biological and psychological health (the prevalence of illness and dependence in seniors as well as their self-perception of their health<sup>37</sup>), social health (the relationship of seniors with the outside world), and their economic health (their housing situation, income and poverty in old age).

In this respect, longitudinal studies<sup>38</sup> show that both total life expectancy at 60 years and life expectancy free of illness show a marked socio-economic gradient, which is higher in the groups of higher socio-economic status. Regarding gender, even if women have a greater life expectancy than men, their life expectancy free of illness is lower.

Data from various sources such as the CASEN Survey, the National Health Survey and the National Survey of Dependency in the Elderly, con-

sistently show that as people's ages increase, so, too, does the proportion of people who perceive their health as fair or poor; and also increase the fraction of people affected by illness and/ or by physical ailments and by mental illness, especially depression and dementia<sup>39</sup>. This leads to situations in which some seniors become more vulnerable and predisposes them to become dependent on others. Dependency also affects caregivers of the elderly. The National Survey of the Department of Senior Citizens (2010) revealed that the reality of caregivers<sup>40</sup>, which are women 86% of the time, as well as that of dependent elderly people, is precarious because there is a high workload associated with care, without rest periods or free time and with very little help in caregiving.

Another important element in relation to the quality of life of older people is the social support they receive and the inclusion of older people in social networks. According to the National Survey of Dependence in the Elderly (2010) 64% of people over 65 receive daily or almost daily visits by a direct relative or close person, while 40% reported having visits with friends on a daily or almost daily basis. 65% say they have someone to turn to if they need help. Over 78% reported that they have the skills to maintain social relationships and over 70% reported that they find it easy or very easy to maintain social relationships.

However, participation in organized groups such as community groups, organizations, clubs, among others, reaches only 36% of older people. In general, women are showing better social integration than men across all of the indicators above.

Today, the National Service for Elderly (SENAMA) is the government body responsible for coordinating public policies aimed at this age group. The supply of public programs available to seniors in Chile cover different aspects of daily life, the majority of which are focused on: health,

37 These three elements are health indicators.

38 Using data from the Survey on Health, Wellness and Aging (2004).

39 Dementia is defined as a syndrome characterized by multiple cognitive deficits severe enough to alter their professional or social functioning. According to the National Study of Dependence in the Elderly, the overall prevalence of dementia in people aged 60 and over was 7.7 % in women and 5.9 % in men and higher in residents of rural than urban areas (10.3% vs 6.3%, respectively).

40 95% of caregivers are a family member and 86% of caregivers are women.

transportation, housing, bonds and cash subsidies. However, there is an evident deficiency in the coordination of programs between the private sectors, community, and social organizations and this lack of coordination hinders efforts to better identify local needs and to increase access and benefit coverage.

### **a) Income and poverty of senior citizens**

The income of people over 60 is generally lower than that of the rest of the population, mainly due to the fact that they are phasing out of the labor market. According to CASEN (2013), in Chile, the independent income<sup>41</sup> of people over 65 is equivalent to about 67% of the income of the rest of the population<sup>42</sup>, and when subsidies are considered as part of their income (monetary income<sup>43</sup>) this ratio increases to 70%. Another important fact is that of all people over 60, 91% receive some individual income, either from independent income or cash grants. This means that 9% of people over 60 do not receive autonomous monetary income<sup>44</sup>. Therefore, they are completely out of the pension system altogether and do not receive benefits from either the contributory or the non-contributory pillar. Level of education is a predictor of increased revenue generation and it could suggest a better quality of life. On average, in the last decade, the education of the seniors has increased. In 2013, people aged 60 had an average of 7.6 years of schooling, compared to the 11 years of education that is the average among the rest of the population (CASEN, 2013).

Finally, the elderly are not the group with the highest concentration of income poverty in Chile

today—which is not only the case for Chile, but true for most of the countries in the region<sup>45</sup>. The percentage of seniors whose income suggests that they are living in poverty, according to CASEN 2013 and the traditional methodology, is about 3.9%, and is about 10.3%<sup>46</sup> for the whole population. When poverty is measured using the methodology of multidimensional poverty, however, which considers the dimensions such as education, health, labor and social security and housing, there are still clear differences between poverty rate of the total population and that of senior citizens: the total population's poverty rate is 15%, and senior citizens' is 8.5%. Both percentages are higher, which reflects the fact that people older than 60 live in a more precarious situation in terms of multidimensional poverty than in terms of income poverty.

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41 "Autonomous income" consists of income from salaries and wages, earnings from self-employment, self-supply of goods produced by the household, bonuses, perks, rents, interest and retirements, pensions, widows' pensions and transfers between private actors.

42 As a reference, the average of this indicator for OECD countries is 86.2%.

43 Monetary income is the sum of autonomous income and cash benefits received by all household members, excluding in-house domestic work. Monetary subsidies correspond to all cash contributions received by all household members, excluding in-house domestic workers, through state social programs.

44 It is interesting to analyze the situation of this one 9% of older people and to see what proportion of those who, fulfilling the requirements of age to access to the contributory pillar or to the not contributory one, are not perceiving income.

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45 For more details on the methodology used to calculate the indicators of poverty by income and multi-dimensional poverty, see Background Chapter 2 of the Final Report.

46 An outstanding issue is the utilization of baskets differentiated by age groups to be able to evaluate the affirmation of relative poverty between different groups.

**Table 6. Poverty of the total population and of senior citizens in 2013 according to the traditional methodology (TM) and the new methodology (MN)**

Poverty	Total population		Aged over 60	
	TM	NM	TM	NM
<b>Extreme poverty</b>	2.5	4.51	1.0	2
<b>Non-extreme poverty</b>	7.8	9.9	2.9	6.5
<b>Not poor</b>	89.7	85.6	96.1	91.6
<b>Total</b>	<b>100.0</b>	<b>100</b>	<b>100.0</b>	<b>100</b>

Source: The Commission's own calculations, based on Casen Survey 2013

### **b) Households where elderly reside**

Family and households are an important category of analysis because it is the interactions among household members that affect the welfare of each of those members. It is a unit of consumption, transfers and work. It is in the home, for example, that people generate the needs, incentives and limitations for its members to interact with the pension system. This analysis can be done from the perspective of those who are older adults and who are still in the "active" phase.

Because of the progressive and accelerated aging of the population, a larger proportion of people live in households with at least one person over 60 years old, and in many of these households the primary breadwinner is a senior citizen. According to CASEN 2013, in 2013, 36 % of the population lived in households with at least one person over 60 years old. In addition 50% of seniors older than 60 years old lived in households where the primary breadwinner is a senior citizen.<sup>47</sup>

Homes with seniors are generally smaller than those where there are no members over 60 years old. While 64.5 % of households with older adults have less than 4 members, 65 % of households without seniors are composed of 4 members or more (CASEN, 2013). From all people aged over 60, 13% live in households on their own, 34% with one other person and 22% live with two other people.

Moreover, a higher proportion of the heads of households that take in older adults are women

rather than men. Of all female-headed households, 43.5% are households where an older person lives, while 36.2 % of male-headed households include an elderly person (CASEN 2013).

The proportion of households with older people in income poverty is lower than the proportion of homes without seniors in income poverty. 17% of households where there is no one over 60 fall under the income poverty line, while 10% of households in which there are minors or people aged over 60 are in the same situation, and only 6.5 % of households who only have people who are over 60 are under this line (CASEN 2013).

<sup>47</sup> For more details, see Background Chapter 2.

**Table 7. Poverty rate by household type (2013). New Methodology**

Household type	Distribution of senior citizens by household	Extreme poverty	Non-extreme poverty	Total poverty
<b>Household Type 1. Households without senior citizens</b>	0%	5.5%	11.4%	<b>16.9%</b>
<b>Household Type 2. Households with senior citizens and where the head of household is not a senior citizen</b>	11%	3.2%	6.8%	<b>9.9%</b>
<b>Household Type 3. Households with senior citizens and where the head of household is a senior citizen</b>	50%	3.1%	7.6%	<b>10.7%</b>
<b>Household Type 4. Households that are entirely made up of senior citizens.</b>	39%	1.2%	5.3%	<b>6.5%</b>

Source: the Commission's own calculations, based on CASEN Survey 2013

### c) Labor market and Labor avoidance

Pension savings and self-financed pensions are directly affected by employment, job quality, and job continuity, since these factors determine the capacity of a person to accumulate a higher balance in their individual capitalization account.

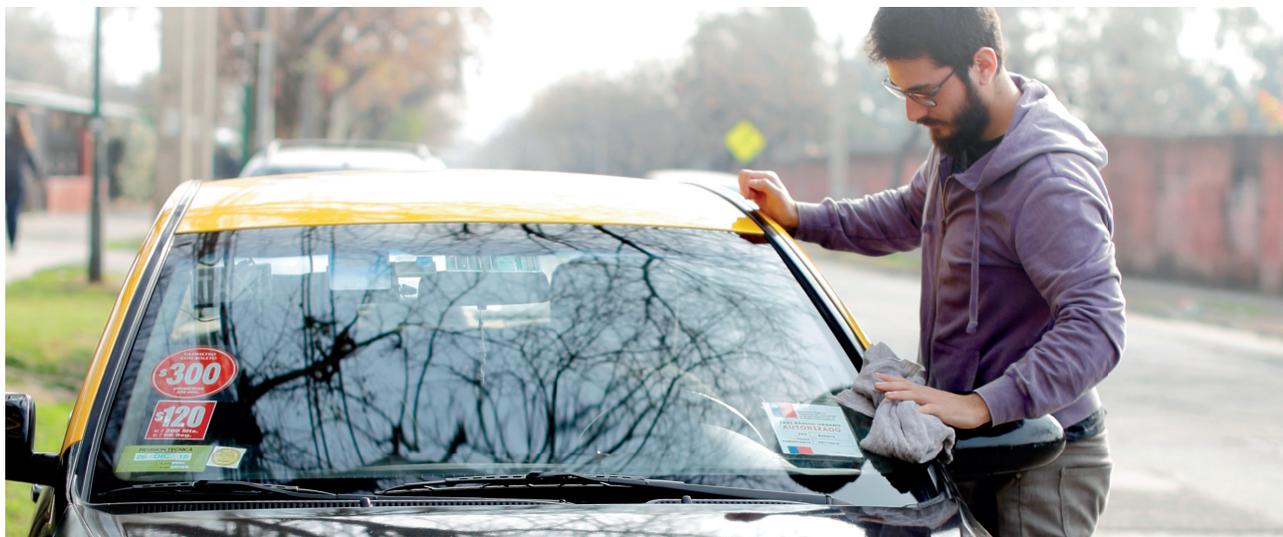
Job entry patterns and job continuity strongly affect the level and frequency of people's contributions during their active working life.

Labor avoidance and contribution evasion also negatively affect pension saving, since they imply a lower number of contributions, because under-reporting income leads to a lower amount of

affiliate contributions and ultimately lower accumulated savings.

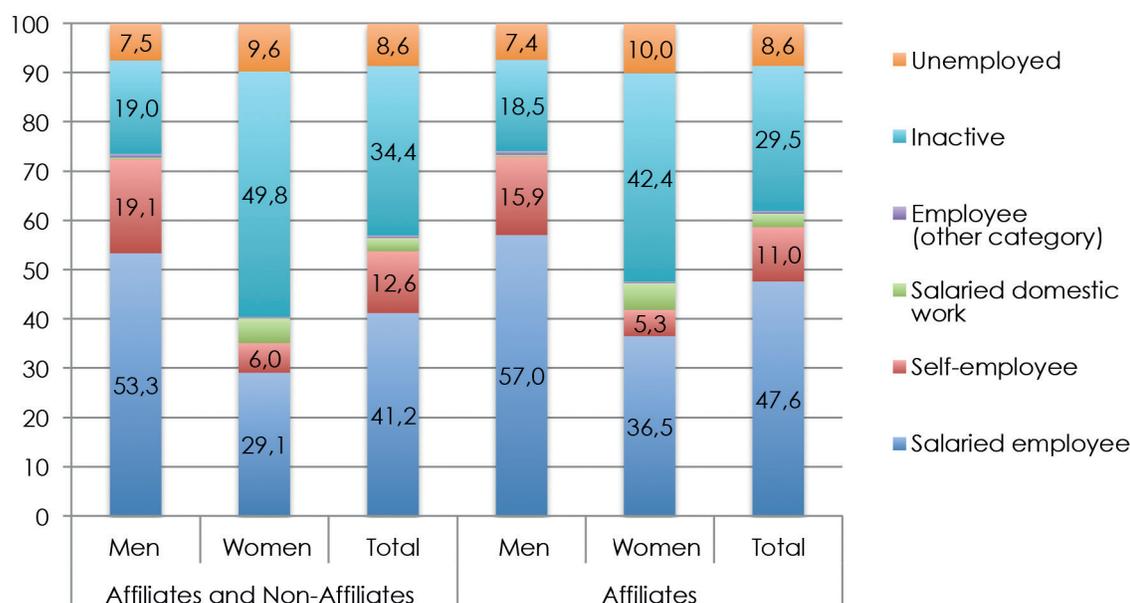
### Patterns of Employment

Data from the 2002-2009 Survey of Social Protection in Chile shows that on average, people between 18 and 60 years old have spent 41.2% of their time occupied as employees, 12.6% of their time as self-employed, 34.4% in downtime and 8.6% in unemployment. However, this situation differs significantly between men and women. While the men pass 53.3% of their time as salaried employees, women spend 29.1% of their working life as salaried employees. In fact, women spend a greater proportion of time—almost half their lives—without earning an income (49.8%).



Graph 6:

**Distribution of working life by Type of Activity 1980-2009.  
Affiliates and Non-Affiliates between 18 and 60 years old (according to Sex)**



Source: The Commission's own calculations with EPS Data 2002-2009

Currently, according to the INE (2014), the Chilean work force consists of 8.3 million people<sup>48</sup>, 94% of whom are employed and 6% of whom are unemployed<sup>49</sup>. In the case of men, 71% of the population 15 years or older are part of the workforce, a figure that rises to only 48 % for women. Add to that the fact that the labor market does not recognize unpaid domestic work done by women, an issue that is echoed by the pension system. The only recognition for unpaid work is the Grant per Child.

### Labor market for people over 55 years old

It is important to note that the integration of young people, women, and groups of lower ed-

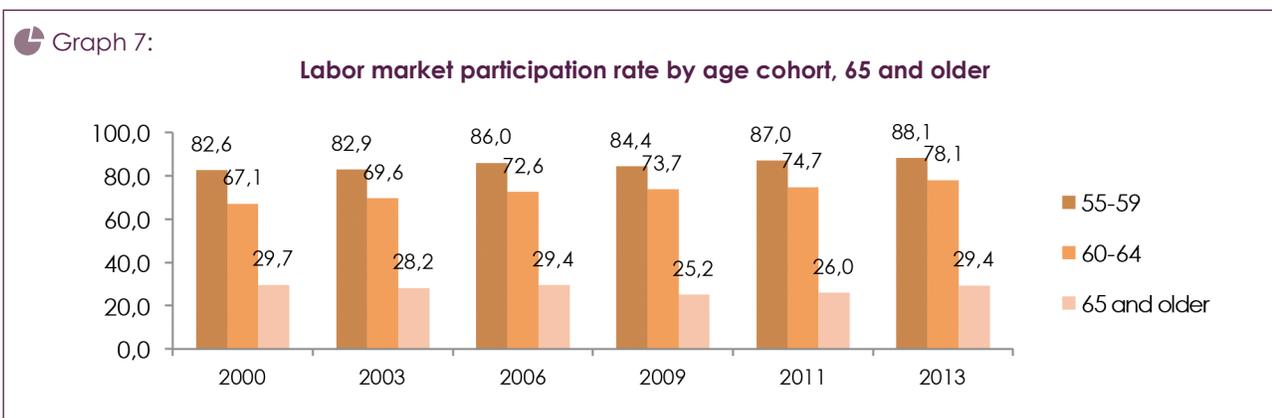
48 The workforce is defined as people 15 years old and over that are either employed or unemployed.

49 The definition of employed is a person that in the survey's reference week fit into one of the following categories: worked one hour or more (as an employee or laborer, as an employee or as a self-employed person, for a salary or income), an unpaid family member that worked for 15 hours or more, or a person that has a job (or business), but did not work in the reference week, due to a temporary absence (vacations, paid leave, short-term illness) or to another reason.

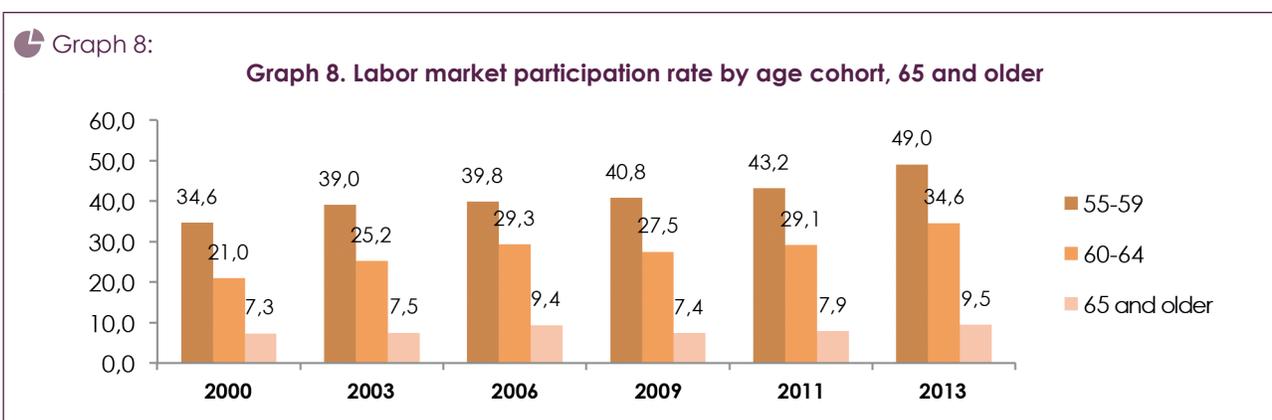
ucational levels into the labor market is significantly different from that of older people, men, and those with higher educational levels. The first three groups face higher unemployment rates, higher levels of inactivity and lower average wages and also have higher rates of informality.

Older people experience a significant fall as a proportion of the labor force and of the employed population, compared to younger age cohorts. While 78% of men between 60 and 64 years old still participate in the labor market<sup>50</sup>, only 29.4% of men over 65 still do (CASEN 2013). In the case of women, while 49% of those who are between 55 and 59 years old participate in the labor market, only 34.6% of women between 60 and 64 years old do. The labor participation rate also is particularly low for the lower quintiles. A high proportion of the jobs of seniors are informal or are types of self-employment, with 40% of retired workers being self-employed.

50 By "participate in the labor market", we are referring to the proportion of people who are working or are looking for work in the working age population.



Source: The Commission's own calculations based on data from the CASEN Survey 2000-2013



Source: The Commission's own calculations based on data from the CASEN Survey 2000-2013

That being said, given the increasing trend, both the participation of people over 50 years old and the real age of retirement from the formal labor market<sup>51</sup> have increased since the 1990s. This means that the average age of men's real retirement is 69.1, and the average age for women is 64.8.

### Contribution patterns

Labor avoidance, lack of contributions and the underreporting of income are all severe problems affecting the performance of the pension system in terms of coverage and the adequacy of benefits. Institutions that regulate and monitor the labor market, such as the labor inspection and tax collection systems are key and show that incentives are not the only determinant in compliance with the law. Participation in the pension is mandatory, but the way to enforce that mandate is by strengthening the state's labor institutions.

According to CASEN 2013, about 5.5% of salaried employees do not contribute even though their employers are obliged to withhold the contribution from their salary (social security evasion) and 12.5% of employees do not contribute because they do not have a contract (labor avoidance). While labor avoidance has decreased from 22%

<sup>51</sup> The real retirement ages from the labor market correspond to the average age that men and women really retire from the labor market. For more details on the methodology used for this calculation, see Background Chapter 2 of the Final Report.

(during the peak of the economic crisis of 1998) to 12.5% in 2011, according to CASEN (2011), there are significant differences between groups of workers. For example, when we differentiate by economic sector, we see that in the agricultural sector labor avoidance is about 28%. Labor avoidance is also higher in smaller companies (39 % in firms with 2-5 people and 22% in companies of 6-9 people). It is higher in job categories associated with informality (characteristics of the contract) and in the lower income quintiles (in the top quintile labor avoidance reaches 26%).

The DL 3.500 establishes that an employer must retain social security contributions and transfer the funds to the Pension Fund Administrators to which workers are affiliated. If the employer does not pay, they have an obligation to declare said payment during the first ten days of the following month with the accrual of income, or present a settlement. This process is known as declaration and non-payment (DNP). By 2013, the accumulated debt was 1.6% of the value of pension funds. This problem highlights the lack of a specific institution that would be responsible for collecting the contribution and complying with the law<sup>52</sup>. There are also bottlenecks in the judicial process of collection, which makes it difficult to recover contributions in debt.

The institutions of the social security system, whose administrative organs belong to the private and public sectors, and are responsible for carrying out this process, are fragmented and isolated. This contributes to the weak enforcement by the Office of Labor to prevent social security evasion and labor avoidance (Advisory Council on Social Security, Pension System User Commission & CIEDESS, 2015).

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<sup>52</sup> According to the study "Analysis and Proposal to reduce Evasion, Underreporting and Judicial Collection of the Pension Contributions" by the Corporación Ciedess, which was commissioned by the Pension Advisory Council and the User Commission. For more details, see Background Chapter 2 of the Final Report.

## Self-employed workers

According to INE, just under 25% of employees are self-employed, whether as an employer or as a person who works for themselves, and these people have barely participated in the system because they have not been required to do so by law. Law No. 20,255 (from the 2008 reform) established the obligation of the self-employed to pay contributions in three stages. In the first stage, which began in 2012 and lasted until December 2014, people were allowed to choose to not contribute and selected this option through a sworn statement on the website of the Internal Revenue Service (SII). Contributions were calculated on the basis of a percentage of the taxable income, which gradually increased from 40% to 100%. In the implementation of the second stage, planned for 2015, the self-employed must make the mandatory contributions for their pension and for work-related accidents. These contributions will be calculated on the basis of their entire taxable income and they will not be able to choose not to pay them. The third stage will begin in 2018 and will require workers to contribute for their health insurance.

The implementation of this obligation has faced a series of challenges. For the tax year 2013, 67% of affected workers declined to contribute, and in the tax year 2014 this percentage increased to 73%, according to information from the SII.

According to data from the CASEN 2013, 9% of women are employed in the category of domestic workers. 51% of these women have either not contributed or have contributed based on an underreported income. 12% of workers that do not contribute fall into the categories of: employers, unpaid family workers and employees working without written contracts.

## Non-taxable allowances

There are stipends and bonuses that increase a worker's salary but that are not considered part of their earnings and are therefore excluded from social security and tax deductions (these include, for example: transportation allowances, reimbursements, money to cover deterioration of tools, per diems, family allowances and bonus compensation for years of service). This has a negative impact on pension savings because it reduces the accumulated savings and there-

fore the affiliate receives a smaller pension. For the public sector, there are a number of stipends that are non-taxable but that would be taxable in the private sector, such as bonuses for working in more isolated geographic areas or allowances for overtime. There are also stipends and bonuses that go untaxed in the private sector, but there is a lack of accurate information about the scale and nature of these amounts.

The tax cap (which was initially 60UF and is currently 72.3 UF) is another factor that leads affiliate's taxable income to appear lower than it really is. 13% of contributors have a taxable income that is equal to or higher than this limit. The limit on unemployment insurance is greater than 100 UF<sup>53</sup>.

#### **d) Gender**

Public policy regarding the population's aging and wellbeing require gender to be considered as a central point. With regards to the pension system, women face an unfavorable situation, receiving, on average, lower pension amounts than men. There are at least four factors that explain this gap: (a) labor market conditions, (b) the division of labor between genders (the distribution of work inside and outside of the household and the manner in which men and women are assigned different roles and expectations), (c) changes in the household structure, and (d) the regulations under which the pension system operates.

Regarding the differences in the labor market, women not only participate less in the labor market than men do, but also suffer "more precarious" labor entry conditions, with important differences for each income group.



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53 For a description of the tax cap see Background Chapter 2.

**Table 8. Labor entry indicators for men and women, by quintiles.**

Income quintiles	Labor participation rate		Unemployment rate		Salaried workers without contract		Workers with indefinite employment		People who do not work because of their caregiving duties to children, senior citizen or other relatives	
	Men	Women	Men	Women	Men	Women	Men	Women	Men	Women
<b>I</b>	50,6	27,8	18,7	21,3	17,3	23,6	16,1	9,3	0,8	14,8
<b>II</b>	64,1	17,7	9,2	13,4	12,2	17,7	29,2	16,6	0,4	13,7
<b>III</b>	70,4	43,4	6,4	8,8	11,5	13,5	38,0	24,7	0,6	10,1
<b>IV</b>	75,9	50,7	3,5	5,1	7,1	10,8	47,8	32,4	0,5	9,2
<b>V</b>	81,0	62,4	2,8	3,8	4,6	6,5	58,9	44,8	0,9	6,3
<b>TOTAL</b>	<b>70,7</b>	<b>45,6</b>	<b>6,2</b>	<b>8,2</b>	<b>8,8</b>	<b>11,8</b>	<b>40,1</b>	<b>26,4</b>	<b>0,6</b>	<b>11,1</b>

Source: The Commission's own calculations based on CASEN data (2013)

There is also the additional factor of segmentation of the labor market by gender. Despite the fact that men and women currently show similar levels of education (around ten years, according to CASEN 2013), the career paths undertaken by both in general show that women, in comparison to men, develop in professions and occupations that are paid less, with less social prestige and work-related appreciation. According to CASEN (2013), women are concentrated to a larger degree in the wholesale and retail industry (22%), followed by teaching (13%) and household services (12%). The figures for men are 17%, 4% and 2%, respectively.

On average, there is an 18% gap between the average salary associated with an hour of work between men and women. This increases with higher educational levels, reaching 40% between men and women who have completed postgraduate degrees.

The work history of women, moreover, is also less complete than men's work history. Men spend 74% of their working history with in paid employment, while women only spend 40% of theirs in paid employment (EPS 2009). The periods of the longest interruption in their participation in the labor market by women are mainly caused by their dedication to domestic labor and the care of children. Cumsille (2015) estimated that women, on average, are outside of the labor market for approximately ten years due to domestic labor, while for men it is 3 years. When women withdraw

for 7 years due to motherhood, men withdraw for 2 years.

The inhibition regarding female participation in the labor market is explained by gender roles, which associate women with the task of unpaid household care, and men to paid employment. This division of labor according to gender is reflected by the fact that women spend on average 4 hours per week with domestic and caregiving activities, while men spend 1.3 hours (EUT, 2007). Men, in contrast, spend on average 5.9 hours a day on paid work, while women spend 2.9 hours a day on it (EUT, 2007). In addition, 11% of women state that they do not work due to family-related reasons – caregiving of children and/or seniors—in comparison to 0.6% of men (CASEN, 2013).

Taking this inter-dependence between the spheres of domestic and labor tasks into consideration, it is necessary to analyze changes in the structure of households and families.

An important transformation in this regard, according to data from CASEN (2013), has been the increase of matriarchal families between 1990 and 2013, rising from 20.2% (1990) to 37.9% (2013). This increase has been proportionally more significant in lower socio-economic strata: 19% households where women are the primary breadwinner belong to the first quintile, in comparison to the 14% of households where men are the primary breadwinner that belong to this

group. In the richest quintile, 23% of the households have women as the primary breadwinner, in contrast to the 31% of households where men are the primary breadwinners in this quintile.

Another relevant change has been the increase of single-parent households, constituted by one head of household with children or step-children. In 1990, 13% of households were single-parent, and this increased to 21% in 2013. At the same time, there has been a decrease of unseparated two-parent households, constituted by a marriage or civil union with or without children or step-children. In 1990, 63% of households fit this definition, and this decreased to 50% of households in 2013. There is also a trend in these changes marked by gender: of all single-parent households, women are the primary breadwinners in 83% while of two-parent households, men are the primary breadwinners in 86%. One-person households are mostly constituted by women (54%). Another change affecting the structure of households has been the sharp increase in cohabitation, which has increased from 3.5% in 1990 to 11.7% in 2013, and the drop in the number of marriages, from 37% in 1990 to 28% in 2013.

These profound transformations in the structure of households, as well as the increase of single-parent households (who are largely headed by women), in addition to the changes in the type of partnerships, should be examined, since some benefits of the pension system assume a certain family structure (for example, the survival pension), and labor and life trajectories (for example, the contributory pillar from the system requires that men and women to have worked and contributed during all of their active lives in order to receive adequate benefits).

Finally, the pension system includes rules that affect men and women's pensions, to the detriment of the latter. One of these is the use of mortality tables to calculate pensions that are based on men and women's life expectancies. Chile currently uses a mortality table (RV-2009) that estimates that women aged 60 have an expected survival rate of 29.64 years, whereas men's survival rate is estimated to be 20.07 years at the age of 65. Another rule of the system is the different retirement age for men and women (65 and 60 years, respectively). This implies that women have a shorter accumulation period than men, while at the same time they have a longer life

expectancy. According to Bertranou and Arenas de Mesa (2003), the replacement rate for a woman retiring at age 65 and another woman retiring at age 60 is 19 percentage points greater. The Marcel Commission (2006) estimated that retiring 5 years earlier reduces the amount of pensions between 30% and 40%. Both rules result in different self-financed pensions for men and women, at the same rate of contribution.

## 2. Social Security Industry<sup>54</sup>

As it was mentioned above, since 2008, the pension system has included both a contributory pillar of individual capitalization and a no-contributory pillar. The analysis of the pension and insurance industry made here relates only to the contributory pillar.

The logic that undergirds the Chilean system of private pension management centers on the idea that market mechanisms are responsible for defining the optimal supply of AFP services, which, driven by affiliate choice, will compete along various variables, such as prices and expected returns. In a scenario where the contributors value lower fees and there are no artificial barriers to changing from one AFP to another, competition among AFPs should promote high returns on funds and low fees, directly benefiting pension results. All this would happen within the constraints of the regulatory framework in terms of permitted investments, required reserves, and access to information, etc.

The contributory pillar (of individual capitalization accounts) emphasizes the right of affiliates to choose between options that each individual considers efficient in terms of administering the risks that would prevent them from running out of funds in their later years. It does not highlight the right to social protection. Since the implementation of the system in 1981, it has tended to construct a regulatory framework of institutions focused on the AFP industry, to the detriment of institutions that would guarantee the solidarity inherent in an adequate system of social protection, an aspect that began to be corrected only in 2008.

<sup>54</sup> This section refers to material from Background Chapter 3 of the Final Report.

On the other hand, past performance of funds shows a higher profitability than was expected when the pension system was designed (4%). This performance notwithstanding, people's perceptions of the real profitability of the funds, while important, is far below what has traditionally been touted as the gross return on funds.

### Competition and Fees

Historically, the system's assets (the managed funds plus the required reserves) have been concentrated in a low number of actors. Even in the most competitive years of the industry (1991-1997), with over 20 administrators operating in the system, over 50% of the total assets was managed by only 3 AFPs.

Currently, the average fees charged by AFPs are 1.14%. It is important to note that in Chile the fees charged by AFPs are charged based on the affiliate's taxable income, and only when the affiliate makes a contribution. This is different than how fees are charged in other countries. In Mexico, for example, companies generally charge a percentage of contributors' assets each year. This difference makes it difficult to compare the fees charged in Chile to capitalized pensions abroad. However, studies that estimate the value of the fees in Chile as compared to other Latin American countries concluded that, using a life-savings of 40 years, the fees in Chile are in the middle<sup>55</sup>.

**Table 9. Fees Charged and Offered in the Bidding Processes and the percent of affiliates of each AFP**

AFP	First Bidding Process (August 2010 – July 2012)		Second Bidding Process (August 2012 – July 2014)		Third Bidding Process (August 2014 – July 2016)		% AFILI- ATES BY AFP	% AFILI- ATES BY AFP	% AFILI- ATES BY AFP
	January 2010	Offer	January 2012	Offer	January 2014	Offer	August 2010	August 2012	August 2014
<b>Capital</b>	1.44%	--	1.44%		1.44%	--	22,3%	20,5%	18,8%
<b>Cuprum</b>	1.48%	1.32%	1.48%		1.48%	--	7%	6,8%	6,6%
<b>Habitat</b>	1.36%	1.21%	1.36%		1.27%	--	25,3%	23,4%	21,5%
<b>Planvital</b>	2.36%	1.19%	2.36%	0.85%	2.36%	0.47%	4,5%	4,3%	4,0%
<b>Provida</b>	1.54%	--	1.54%	--	1.54%	--	41%	37,3%	34,1%
<b>Modelo</b>	--	1.14%	1.14%	0.77%	0.77%	0.72%	0,001%	7,8%	15,1%

Source: The Commission's own calculations based on data from the Superintendencia of Pensions

55 Kritzer, Kay, Sinha (2011). Next Generation of Individual Account Pension Reforms in Latin America.

Regarding the fees charged by the AFPs, it is important to highlight the role of the bidding process for the portfolios of new affiliates that was introduced in the pension reform of 2008. The three bidding processes carried out to date have lowered the fees charged to new affiliates to 0.47% of taxable income. This amount is considerably lower than the average AFP fee before the introduction of this new mechanism, which was about 1.63%. The first bidding process, held in 2010, allowed for the entry of a new AFP into the market, with a fee of 1.14%, 16% lower than the lowest fee charged prior to the bidding. The second bidding process, completed in 2012, was won by the same AFP, who reduced the fee by 32% with respect to the first offer. Finally, in January 2014, the third bidding process was conducted, in which the incumbent AFP was awarded the portfolio of new affiliates with an offer that was 39% below the fee charged by the winning AFP in the second bidding process.

The percentage of affiliates who benefit from the lower fees of the two winning AFPs reached 20% as of August 2014. In this sense, there has not been a massive transfer of affiliates to the cheapest AFP. In other words, 80% of affiliates are still paying 1.27% or more in fees. This shows that affiliates are not very sensitive to the fees charged by AFPs. Approximately 400,000 affiliates transferred from one AFP to another in 2014, equivalent to less than 5% of the affiliates in the system. Moreover, there is no evidence<sup>56</sup> that such transfers are to the cheapest or most profitable AFPs. As a result of this, the percentage of beneficiaries who access the lower fees created by the bidding process is low.

Affiliates' low sensitivity to changing fees is a result of several elements that were already highlighted in the Marcel Commission report, which also pointed out that not even the bidding process modified this insensitivity. Among these elements, one important aspect is the clear evidence of affiliates' poor understanding of the system. Indeed, according to the opinion poll commissioned by the Commission, only 13% of men and 7% of women know how much their AFP charges them in fees<sup>57</sup>. Other factors that ex-

plain the low mobility between AFPs in reaction to relevant changes in the system's variables include: the compulsory nature of the system, the complexity of the savings decisions required to finance consumption in the long term, especially in the case of self-employed or low-income workers, the difficulties of affiliates to correctly assess the need to contribute and save, and the low level of financial literacy that would help affiliates make decisions. Another factor that may be influencing the level of fees are the other elements that people value offered by AFPs, such as a sense of security and trust, which are more easily generated by the largest AFPs (which have a better developed brand and can spend more on advertising), as well as other levels of better services (by having more branches or customer service channels, etc.).

The current fee structure, defined as a fixed percentage of taxable income for all affiliates of the same AFP, was designed to deduct the fee from people's incomes so that they would be more sensitive to decreases in fees because their take-home incomes would grow with each decrease. If it were not a fixed percentage, the system of fee collection would reduce the incentives for the AFPs to compete for prices; instead they would compete for the percentage of income. Because higher-income affiliates generate higher fees in absolute terms, if it were possible to charge different fees, AFPs would have incentives to lower fees only for this segment of affiliates. However, since there is a single fixed fee, it is inconvenient for an AFP to lower the fees for all affiliates. Despite this, the great advantage of the uniform percentage fee is in equity, since it generates a cross-subsidy from the high income segments to the low income segments. But this does not prevent the tendency of AFPs to select high-income affiliates.

In another area, although there are funds with different levels of risks, the fact that fees are a percentage of income and do not reflect fund performance, means that the financial risk of pension fund investments falls solely on the affiliate's shoulders. The high volatility of the markets, exemplified during the financial crisis of 2008, is transmitted to the funds that are made up of affiliates' contributions<sup>58</sup>.

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56 For more details, see Background Chapter 3 of the Final Report.

57 For more details, see Background Chapter 3 of the Final Report.

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58 For more information about historical rates of return, see Background Chapter 3 of the Final Report.

In addition to normal contributions, article 45 of the DL 3.500 establishes the mediation fees as those derived from foreign investment of national mutual funds from AFP administered funds through financial intermediaries. These fees are charged to the balances of the affiliates, which is why when we assess the level of fees we have to add these mediation fees to the fees based on the affiliate's income.

The possibility of greater price competition is evident by looking at the return on equity of the Administrators of Pension Funds during the last decade<sup>59</sup>, except in 2008, which averaged 27%.

The facts described above show that despite efforts to regulate the industry, there is evidence<sup>60</sup> of low price competition, and there is a small percentage of contributors who are affiliated to the AFP that won the bidding process introduced by the 2008 reform and there is a large percentage of affiliates that continue to pay higher fees.

### Rate of Return

Between 1981 and 2013, the average annual rate of gross return (without deduction of fees) of the pension funds was 8.6%, which is high in comparison to the returns that were expected when the system was designed. But during the first few years of the system, it saw particularly high returns, in the double digits. It is hard to determine to what extent the performance of the funds reflects sound management on the part of the AFPs as opposed to particularly favorable market conditions or careful regulation. In this sense, without a study comparing the funds' performance to similar reference portfolios, it is difficult to assess whether the return rate was due to fund management or to the market's performance.

These rates of return have gradually decreased over time and projections indicate that they will continue to drop due to increasing diversification in foreign investments, which results in the portfolios of the pension funds tending to show similar returns to their counterparts from developed countries. Lower return rates directly affect pension fund accumulation, resulting in lower pensions.

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59 This corresponds to the percent of return (utility after taxes) that the company has obtained over their equity, excluding this last utility or loss in the exercise in question and adding the dividends that were declared during the exercise.

60 For more information, see Background Chapter 3 of the Final Report.

### Gross returns versus individual account returns

The observed returns on pension funds, which are generally reported, are above the return of individual accounts, as measured through the internal rate of return (IRR). The participation in the individual capitalization system can be understood as an investment project with investments carried out in each period through contributions and fees paid to the AFP, resulting in a positive return (the total accumulated balance of the individual account) that is granted at the time of the affiliate's retirement. The return rate of the individual account, or rather the internal rate of return (IRR), measures the earnings or effective loss, after deducting the cost or fees that every affiliate has in his or her mandatory contribution account. This indicator takes the affiliate's whole contribution history into account, including the payment of fees and the investment decisions made during each time period. One of the main features of this indicator is that it considers all of the affiliate's "inputs", including all of the affiliate's individual contributions and all the fees they pay to the AFP, as investments. In this case, the fees charged by the AFPs are grouped together with the rate of return, despite the fact that the fees charged as a percentage does not directly affect the balance of the individual capitalization account.

The calculation of the internal rate of return (IRR) for those affiliates that have contributed at least once between 1981 and 2009 shows significant differences between the IRR with and without fees. The real IRR for women is 3.0% when one takes the fees into account and 5.4% without the fees. In the case of men, these figures reach 3.1% and 5.4% respectively. This demonstrates that there are significant differences between the Individual Capitalized accounts (IIR) and the returns from the AFP-administered funds. The fees charged by the AFPs are important in order to explain differences in the return rate of the individual accounts. The frequency of contributions and the moment of contribution during the life cycle also have a central part in explaining the return rate of the individual accounts<sup>61</sup>.

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61 Commission Member Martín Costabal has requested that his concerns related to the value of the indicators mentioned in this paragraph concerning the relevant deviations of the measurements based on the system's global statistics be noted.

## Multi-funds

With regards to the investment portfolios that the AFPs offered to affiliates, at the end of 2002, the multi-fund system was created. This system offered to the affiliates five different types of funds, whose main difference was their level of exposure to equities. The aim of this system is to increase the expected value of pensions by tightening the link between risk and return according to the affiliate's individual investment horizon. Additionally, it presents an opportunity for the affiliates to invest their resources according to their own preferences and risk aversion profiles. When the multi-fund system was established, all affiliates were asked to pick the type of fund they preferred for the investment of their savings. Those who did not actively make a decision were assigned to a default choice that includes the transition through the intermediate funds (B, C and D) throughout their active working life. This default strategy was designed to follow the logic of an affiliate's life cycle, in which the most risk is assumed at the beginning of their active life, and the exposure to risk gradually decreases with age. Currently, this system is still in place as the default strategy for those that have not chosen a type of fund for their savings.

The first relevant question is whether having a system of multi-funds, like the Chilean system, with funds that can invest a high percentage of their money into stocks (such as the case with Fund A), is consistent with the logic of social security. This possibility of risky investments results in high volatility, which in the case of the 2008-09 crisis provoked a 40% drop of Fund A in three months. The multi-fund system has given affiliates the possibility of changing funds of and transferring from one fund to another if the affiliates deems it necessary. The number of affiliates who remain in the default fund has gradually decreased, from 90% at the beginning of the system to 60% in December 2013. The transfers among funds were lower until 2008, when the crisis struck and the significant falls of the riskier funds resulted in an increase of the number of transfers. Between 2008 and 2011, the number of transfers was similar and remained steady.

Evidence reveals that the performance of accounts of affiliates who have actively switched funds is negative when compared to various benchmarks. For example, for the group of affli-

ates that switched funds between 2008 and May 2013, 82% had a lower return rate than the default strategy and 72% had a lower return rate than what they would have received with a passive strategy. Another important point is the fact that among the affiliates who requested their old-age pension during 2013, close to 4.5% requested it with part of their savings invested in pension funds A or B, both of which suffered significant losses during the 2008 financial crisis.

This evidence shows the complexity involved in granting affiliates the power to make such important decisions, especially considering that most of them do not have the minimum level of financial literacy required to make these decisions knowledgeably. Even for affiliates with a higher educational background, it is very questionable as to whether an active investment strategy (market timing) through fund transfers could lead to better results than the passive strategy.

## Pension modalities

As mentioned in previous sections, in the current system there are three pension modalities: Programmed Withdrawal Pension, Immediate Annuity and Temporary Deferred Annuity. Some alternatives such as the Annuity with an Income for a Guaranteed Period (a period certain annuity)<sup>62</sup> and the possibility of combining two pension modalities are also available.

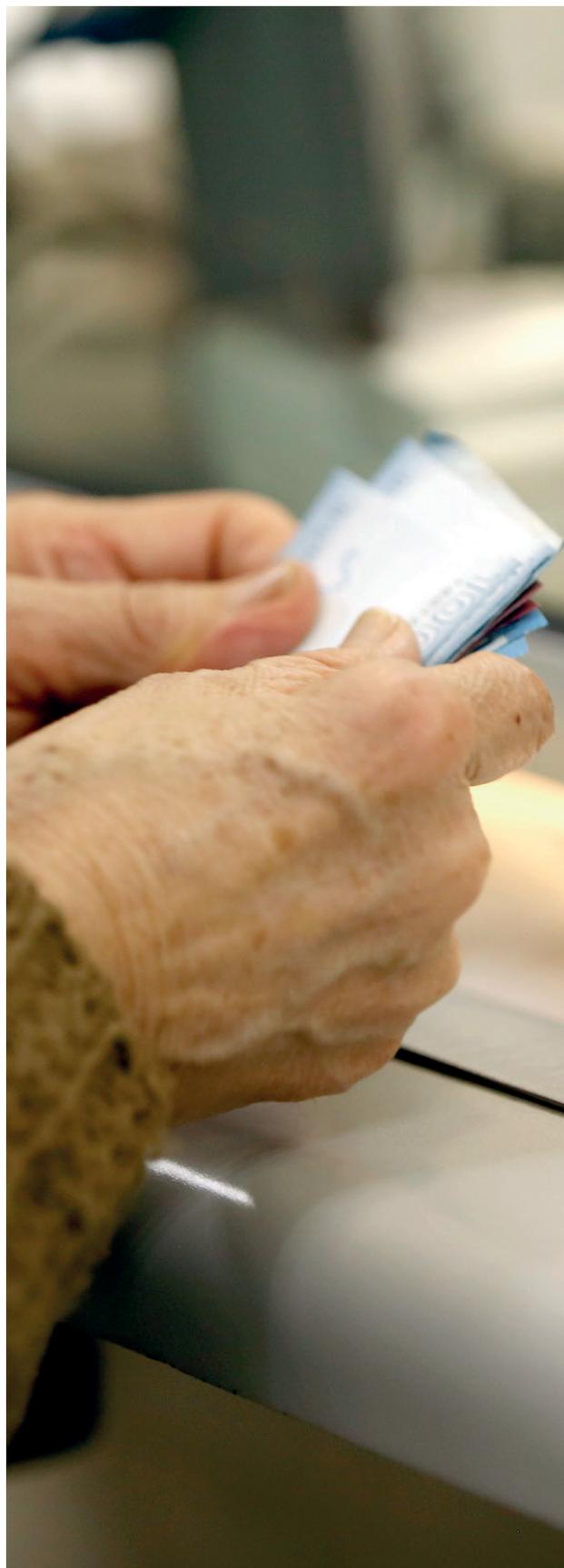
The difference between the two main pension modalities, Programmed Withdrawal and Life Annuity, is that in the first, workers keep their individual account with the Administrator to which they are affiliated, with the pension amount being recalculated every year considering factors such as the accumulated balance, their life expect-

<sup>62</sup> With "Temporary deferred annuities", the affiliate contracts with a Life Insurance company for a monthly annuity payment to start at a future date, leaving a balance in their AFP account for a temporary annuity for the period between when the affiliate makes the contract with the Life Insurance Company and the start date of the deferred annuities. The temporary deferred annuities are calculated annually, assuming expected returns for the funds during the period between the date of the calculation or recalculation and the beginning of the temporary deferred annuity. Its value will vary according to the actual return rate of the fund, and the supposed return rate. In contrast to Programmed Withdrawal, adjustments associated with life expectancy are not considered (there is no use of mortality tables in the calculation), which is why there is no creation of a profile which decreases in time.

tancy, legal benefits and future account returns; in contrast, under the modality of Life Annuities, affiliates can transfer their pension contributions to a life insurance company, which commits to paying constant monthly real returns for the rest of their lives, also paying survival pensions to their beneficiaries.

The following table compares these pension modalities for different dimensions:

- » Programmed Withdrawal (RP)
- » Simple Immediate Annuity (RVI)
- » Simple Immediate Annuity (RVI) with Programmed Withdrawal (RP)
- » Simple Immediate Annuity with a Guaranteed Payment Period (period certain annuity) (RVI-PPG)
- » Temporary Income with Simple Deferred Annuities (RT-RVD)



 **Table 10. Comparative table of pension modalities**

Characteristics	RP	RVI Simple	RVI – RP	RVI- PPG	RT- RVD
Administration	AFP	Life insurance company	RP: AFP RVI: Life insurance company	Life insurance company	RT: AFP RVD: Life insurance company
Is it possible to change the modality of pension?	Always	No	RP: Always RVI: No	No	RT: Always RVD: Only in before taking the pension
Who owns the funds? (Whose property is the fund?)	Affiliate	Life insurance company	RP: Affiliate RVI: Life insurance company	Life insurance company	RT: Affiliate RVD: Life insurance company
Pension amount	Variable	Constant	RP: variable RVI: constant	Constant	RT: variable RVD: constant
Who assumes the risk- return of investment?	Affiliate	Life insurance company	RP: Affiliate RVI: Life insurance company	Life insurance company	RT: Affiliate RVD: Life insurance company
Who assumes the risk of the individual's longevity?	Affiliate	Life insurance company	RP: Affiliate RVI: Life insurance company	Life insurance company	RT: There is none RVD: Life insurance company
Who assumes the risk of the mortality tables?	Affiliate	Life insurance company	RP: Affiliate RVI: Life insurance company	Life insurance company	RT: There is none RVD: Life insurance company
Is it possible to leave it as an inheritance (not legal beneficiaries)?	Always	No	RVI: No RP: Always	PPG: Always Rest of the period: No	RT: Always RVD: No
Is there a risk of the Administrator going under?	No	Yes, with the limited guarantee of the State	RP: No RVI: Yes, with the limited guarantee of the State	Yes, with the limited guarantee of the State	RT: No RVD: Yes, with the limited guarantee of the State

Source: The Commission's own calculations.

The calculation structure of the programmed withdrawal modality leads to pensions that are projected to decrease in time, which goes against the aim of any pension system that seeks to smooth consumption. However, this is the only pension modality in which the person always maintains ownership of the fund, and is able to leave it as inheritance. This is important to people who are not interested in an annuity pension, knowing that for health reasons they cannot expect to live much longer.

A major problem with annuities is that they expose the affiliate to the high risks associated with the stage in the economic cycle that they reach when they retire and with the associated implied return rate offered by the insurance companies. In other words, an affiliate could have been saving for their whole life, and just as they retire they could be affected by a very low implicit return rate offered by the annuity pension, which is detrimental to their pension throughout their retired life. To mitigate this reality, some affiliates at first chose a programmed withdrawal pension, and once the return rates improve they switch to an annuity.

Lastly, it is important to mention the discriminatory use of gender segregated mortality tables in the calculation of the programmed withdrawal and in the technical reserves the insurance companies need to set aside to cover the financial risk associated to the sale of annuities. These gender segregated tables have a direct impact on the observed gaps in the pension amounts granted to men and women, respectively.

Having said that, it is an objective fact that women live longer, and using the same mortality table for different realities also leads to issues. For example, if the programmed withdrawal is calculated for a woman using men's mortality tables, she would receive a higher pension in the first years, but thereafter she would receive extremely low pensions given that women will live longer than expected according to the table. If women's mortality tables are used for everyone, the opposite effect would be observed in the case of men (who, on average, would live for less time than is to be expected).

Therefore, in the case of programmed withdrawal, the use of unisex tables could lead to an adverse effect, to the detriment of women. In this sense, the use of unified tables must go hand in hand with the review of the retirement alternatives, particularly the programmed withdrawal.

### 3. Citizens' understanding and assessment of the pension system<sup>63</sup>

#### Citizens' Understanding of the Pension System

In a pension system that includes an individual capitalization accounts pillar, each person needs to be responsible for making the decisions regarding the accumulation of their funds, such as the number and frequency of their contributions, the choice of which AFP will manage their savings, the investment fund where their savings will be allocated, the retirement age and the pension modality, among other choices.

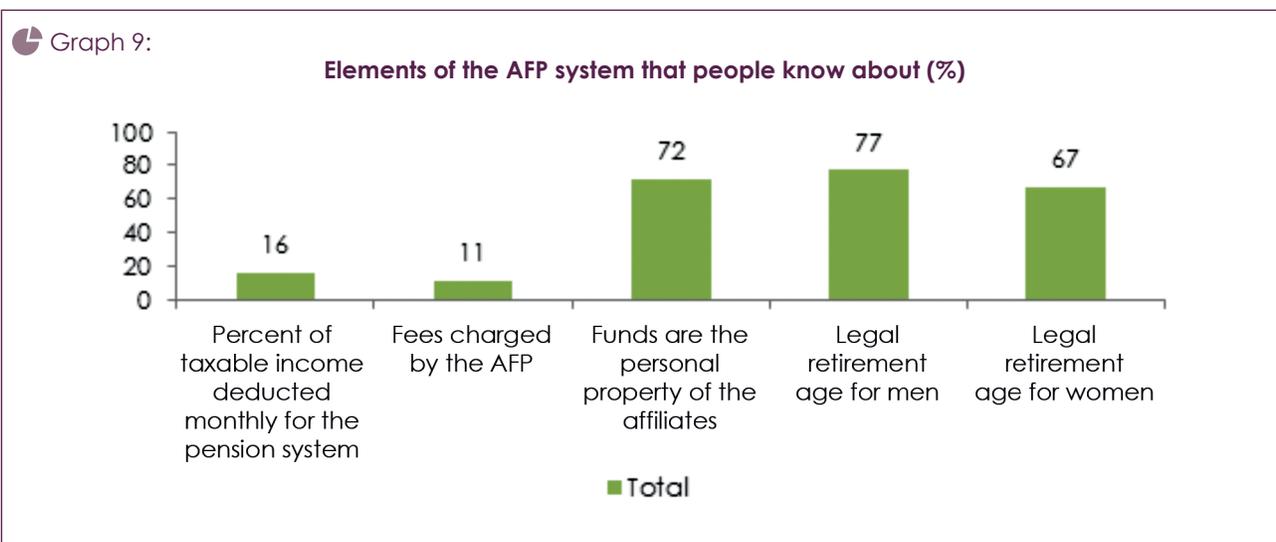
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63 The Pension Commission carried out a far reaching effort of data collection through a process of Citizen Participation, that included 620 phone calls, 760 messages and emails and 79 documents; 15 Regional Citizen dialogues, in which 1,416 people participated; followed by Regional Hearings with the Commission, with a total of 1,170 participants; 78 Public Hearings in Santiago and 10 focus groups; and finally, a National Survey with a total of 3,696 participating households. For more detail, go to Background Chapters 1, 6 and 7 of the Final Report.

Although it affects both the retired and the working population, ignorance of how the system works is more widespread among: younger age groups, women, people with lower income levels and lower educational levels<sup>64</sup>. Regarding the parameters of the pension system referred to in the Opinion Survey carried out by the Commission, only 19% of men and 12% of women know the percent of taxable income that is deducted monthly for the pension system. 11% of people are aware of the fees charged by their AFP. The legal retirement age is the aspect of the pension system that is most widely-known: 77% of men and 67% of women can correctly identify it. With respect to ownership of the funds, 72% of respondents indicates that they know that the funds are the personal property of the affiliates.

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64 For more details go to Background Chapters 2 and 6 of the Final Report.

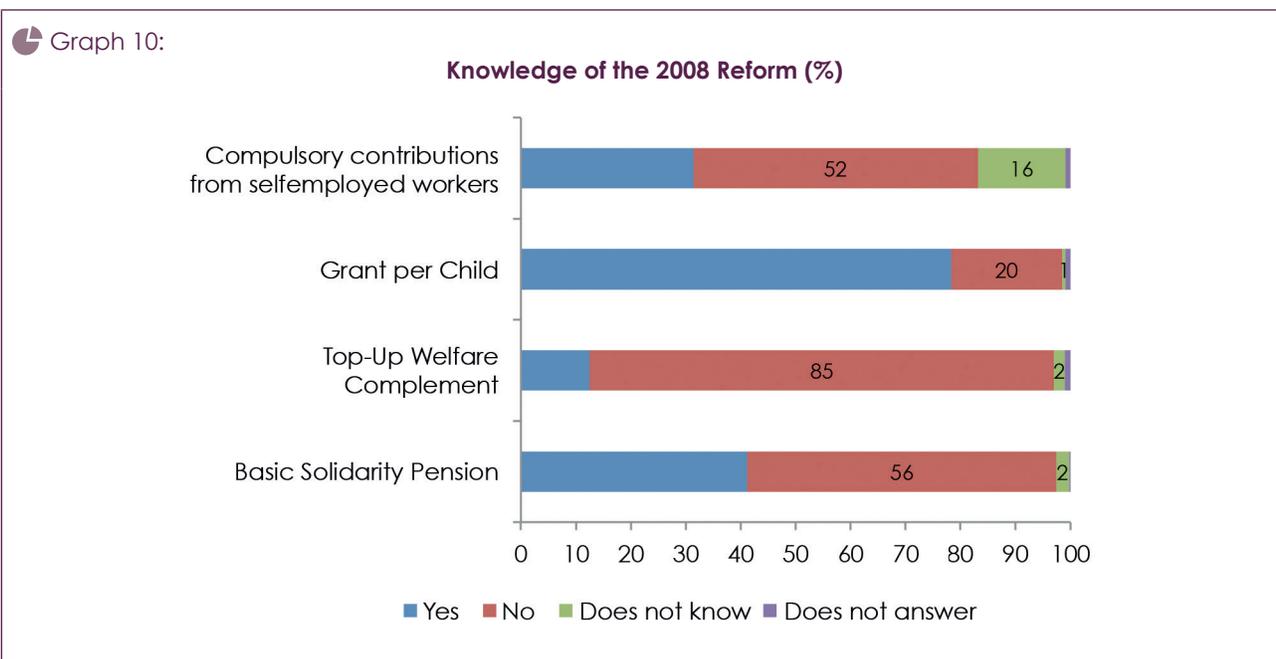


Source: The Commission's own calculations based on the data from the Opinion and Perception Survey on the Pension System in Chile.

The Survey on Social Protection indicates that by 28% of men and 18% of women can correctly identify the contribution rate. 18% of people say they know how their future pensions are calculated, and 45% of men and 38% of women know about the APV. Moreover, more than 50% of AFP affiliates claim that they have not received a statement from their AFP, which is the main method of communication established by law. 33% of men and 26% of women state that they know or

have heard of the multi-funds and know exactly how many funds there are.

Regarding the elements of the 2008 reform, the best-known element is the Grant per Child (78%), followed by the Basic Solidarity Pension (41%), compulsory contributions from self-employed workers (31%) and lastly, the Top-Up Welfare Complement (12%).



Source: The Commission's own calculations based on the data from the Opinion and Perception Survey on the Pension System in Chile Total sample: 3,696.

This lack of knowledge is exacerbated by the fact that there are limited instances of welfare education. One of the few initiatives is the Welfare Education Fund (Fondo de Educación Previsional, FEP), administered by the Undersecretary of Social Security, and created by the 2008 Welfare Reform. Its objective is to give financial support to projects, programs, and activities that educate the public and that promote and raise awareness of the pension system. To date, there have been seven public bidding processes to fund projects that promote, educate and disseminate information about social security. The DIPRES carried out an evaluation of the FEP in 2012, pointing out some aspects that need improvement, such as developing a strategic outlook and developing adequate instruments and indicators to monitor the performance of the program, among others. The User Commission<sup>65</sup> has given similar recommendations. This shows that public policy has also failed to make real progress on a key issue that would improve the pension system.

### Citizens' evaluation of the pension system

The Opinion and Perception Survey shows that the majority of the public has a negative impression of the AFPs, with 72% of the population believing that *"only a complete overhaul of the AFP system would help to improve pensions"*. 66% agree that *"low pensions are the AFPs' fault"*. 60% strongly disagree with the statement *"I am comfortable with the AFPs' management of the pension savings"*. According to the trust level question, they are the fourth least trusted institution after the political parties, Congress and health insurance companies.

Moreover, 79% of people who expressed their opinion agree with the creation of a public AFP, and 69% would transfer to it if it existed. At the same time, 29% of people believe that the State should be responsible for pensions through general taxation, while 24% believe individual effort should be the main determinant of pension amounts.

Regarding the introduction of changes to the system, there are different opinions regarding an increase in contributions: 25% are not willing to increase the contribution rate, while 26% are willing

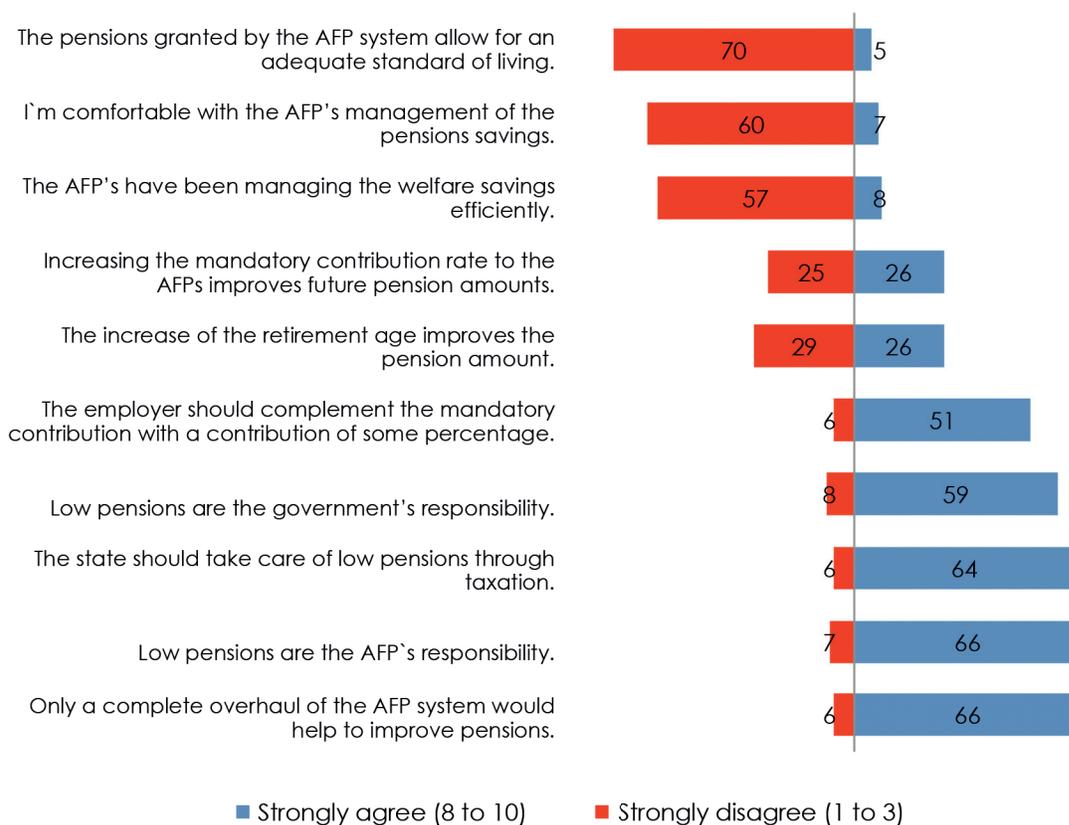
to contribute more; on the other hand, 29% disagree with the statement *"an increase in the legal retirement age improves pension amounts"*, while 26% do agree with the statement. Finally, 51% agree that the employer should contribute a percentage of the mandatory contribution.



<sup>65</sup> Annual reports of the User Commission, particularly from 2014.

Graph 11:

## Level of agreement with different aspects of the AFP System (%)



Source: The Commission's own calculations based on the data from the Opinion and Perception Survey on the Pension System in Chile. Total sample: 3,696.

Note: These opinions were measured using a 1 to 10 scale, where 1 corresponds to "strongly disagree" and 10 is "strongly agree".

According to what was reported in the Citizen Dialogues and the Public Hearings, some people criticize the individual capitalization accounts system for its origin during the dictatorship, for broken promises regarding the replacement rate, and for its performance. Additionally, participants mentioned that the pensions granted by the former pension system, currently overseen by the IPS, are generally vastly superior (the amount varies according to each compensation fund). There was also discussion of the high pension amounts for the Armed Forces and Police Forces.

In the Public Hearings, it was also pointed out that the current pension system does not comply with the principles of social security agreed

upon in the Convention 102 on Social Security from the ILO, which still has not been ratified by Chile. The principles that the Chilean system does not comply with that were discussed in the Public Hearings included: solidarity, adequacy and universality. Some presenters also pointed to the absence of affiliate participation in the management of the funds and to the fact that for-profit institutions handle the pensions.

## B. Results of the pension system

The capacity of a pension system that has an important contributory element is directly related to the extent to which people participate in the system, either by contributing during their active working lives or as beneficiaries of pensions after they retire. The solidarity component also plays a role in guaranteeing that the affiliate has an income that allows them to maintain their quality of life during both their active working life and during their retirement.

### 1. Coverage

The concept of coverage has different interpretations. On the one hand, it refers to the risks covered that, in the case of the pension system, are about smoothing consumption and alleviating poverty during old age, disability and survival. On the other hand, in the case of a contributory system, such as the Chilean system, coverage also refers to the system's capacity to register workers as affiliates and make working age population contribute, and thereby guarantee affiliates an income that will allow for a continuous level of quality of life during both the affiliate's active working life and during their retirement.

#### a. Coverage of the working age population

In a contributory system like the Chilean system, coverage refers to the capacity of the working age population to contribute enough to finance benefits that will be sufficient for them during their retirement. This coverage is the result of a chain of events directly related to people's participation in economic activity as employed affiliates who continuously contribute to the system.

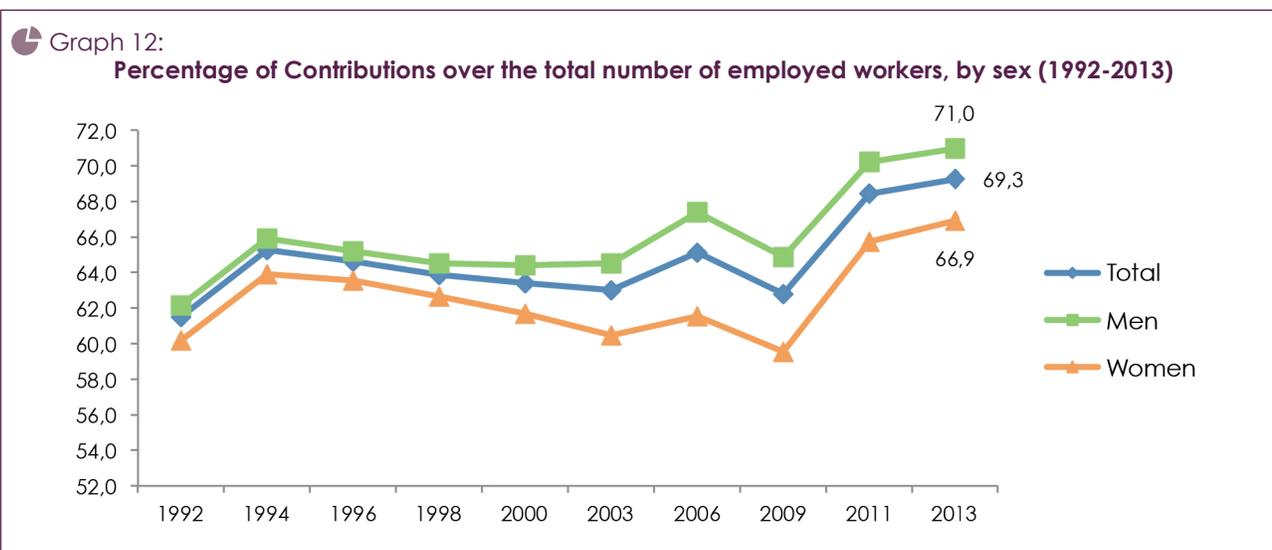
Regarding this dimension, there are two interesting measurements: a static and a dynamic one.

In the first type of measurement, the system's coverage is measured by the levels of affiliation and contribution of the actively working population. In 2013, contributing affiliates represented 65% of the total workforce, and 69.3% of the entire employed population (CASEN, 2013). Although there has been an increase in both types of coverage—in the case of coverage of the active workforce, there was an increase of approximately 7 percentage points and of 8 percentage points if measured against the overall

employed population from 1992 to 2013— 35% of the economically active population in 2013 was still not covered and 30% of employed workers were not covered. The international comparison, however, places Chile among the countries with the highest levels of coverage in Latin America, together with Uruguay and Costa Rica<sup>66</sup>.



<sup>66</sup> For further details please review Background Chapter 4 of the Final Report.



Source: The Commission's own calculations based on Casen 1992-2013

With respect to the dynamic measurement, coverage can also be analyzed as *contribution density (or frequency)*, which refers to the proportion of contributions that an affiliate makes over the course of their working age life.

**Table 11. Contribution Density 1980-2009. Affiliates and Non-Affiliates between 18 and 60 years sold (Administrative Data)**

Percentile	Affiliates (AD 2009)	Affiliates + Non affiliates (AD 2009)
p10	0,0%	0,0%
p25	11,5%	0,0%
p50	39,8%	28,1%
p75	69,2%	64,5%
p90	86,6%	84,2%

Fuente: Elaboración Propia con Datos EPS 2002-2009

Contribution density does not exceed 50% for the total affiliated population. The distribution is very unequal, and is concentrated—for most of the population—in densities below 40%. Half of affiliates have a contribution density that reaches 39.8% (median) and 25% of the population has a contribution density equal to or below 11.5%.

Women consistently have lower contribution densities than men. On average, the contribution density of affiliated women is about 33.3%, but half of the affiliated women have a contribution density that is less than 25.7%. The lowest 25% of affiliated women have a contribution density that is 5% or lower and the contribution density

for the top 25% is equal to or exceeds 56.3%. In the case of affiliated men, the average contribution density reaches 48.8%, half of them have a contribution density equal to or below 21% and the top 25% have a contribution density equal to or exceeds 75.3%.

Low contribution density is associated with work histories in precarious employments, as well as stints of unemployment, informal labor, self-employment and periods of labor inactivity over the course of an affiliate's life. Although unemployment periods have the largest influence on contribution density, from a life cycle perspective,

the periods in which people do not contribute despite working are also important (for example, self-employed workers or people who participate in contribution evasion).

This is added to the fact that in Chile there is widespread contribution evasion, reaching approximately 18% in total and that personal voluntary savings for pensions is not common. Until March 2014, the accumulated amount of APV amounted to \$6,856,000,000 USD, which is 4.5% of the total accumulated pension funds in the mandatory accounts (Superintendencia de Pensiones, 2014). Lastly, the employment subsidy for young people that is intended to increase coverage only covers 3.6% of workers.

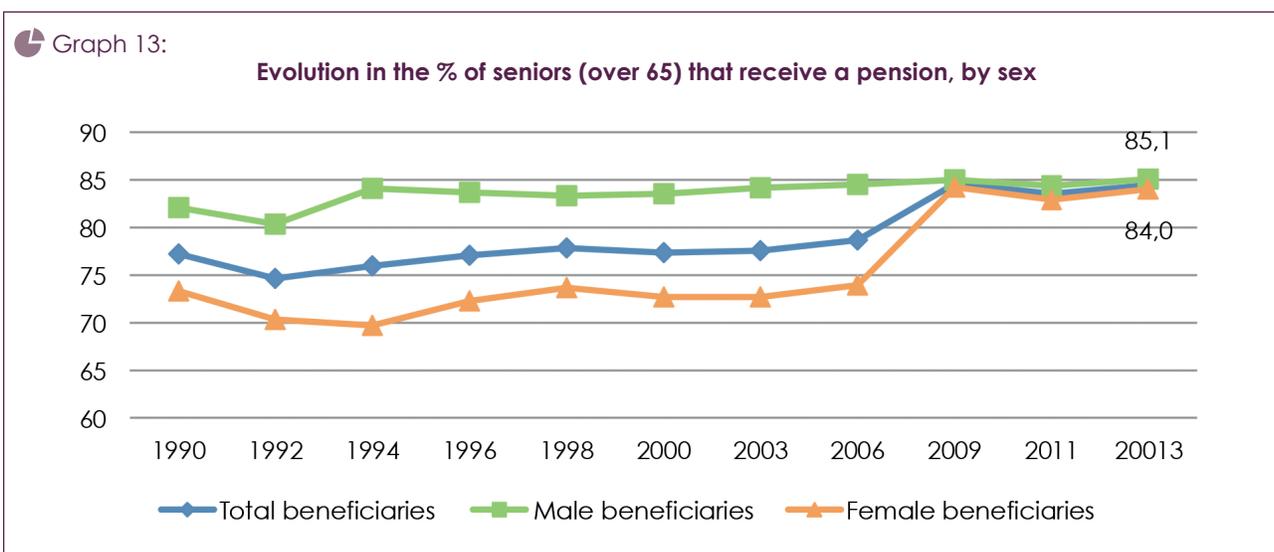
### b) Coverage of Senior Citizens

In 2013, 84.5% of senior citizens over 65 received some type of pension, including contributory and non-contributory pensions, with coverage of women reaching 84% and coverage of men reaching 85.1% (CASEN, 2013). Out of all pensions granted, 70% were old-age pensions, 12.5% were survival or widow's pensions, and 2.7% were disability pensions. An important leap in rates of

coverage began in 2008; while in 2006 the percentage of beneficiaries of some sort of pension was 79%, in 2008 that number reached 84%. This sharp increase was especially important for women, who saw their coverage increase from 74% in 2006 to 84% in 2013.

The increase in coverage was mainly due to the introduction of the Basic Solidarity Pension (PBS), which currently covers 30% of the population over 65—the PBS covers 36.3% of women and 22.3% of men (CASEN, 2013). As a result of the 2008 reform, the proportion of beneficiaries of non-contributory pensions increased from 17% in 2006 to 28% in 2009. This had a major impact on women, as coverage of women during that period went from 20% (2006) to 33% (2009), reaching 36.3% in 2013. The Solidarity Pillar uses targeting criteria, which can lead to errors of inclusion and exclusion. Given this danger, there must be a periodical review of the targeting requirement, which to date has only been carried out once in 2012.

Even considering the progress made in terms of coverage, there was stagnation in rates of coverage in the period between 2011 and 2013, when the rate remained at 84%.



Source: The Commission's own calculation based on Casen 1990-2013

## 2. Benefits

Due to the many effects a pension system can have, it is essential to introduce a design or a reform that takes the system's objectives into account, in order to evaluate the quality of the benefits from that perspective.

Barr (2008) identifies three primary objectives of pension systems: to provide mechanisms that redistribute consumption over a person's life, to alleviate poverty, and to redistribute income. Regarding the distribution of consumption, pension systems should allow people to transfer their consumption from their active working stage to their retirement. To do this, another policy objective must be to give people confidence in the system when they are making their savings choices. When people make their savings choices, they face a wide array of uncertainties. For example, they do not know whether they will live for a longer period than their savings can finance, nor do they know how stable their future income will be over the course of their working lives. Pension systems should help to minimize these risks<sup>67</sup>.

Taking these objectives into consideration, it is possible to measure the adequacy of benefits granted by the system. This section reflects these objectives, presenting results regarding the pension amounts that affiliates received between 2012 and 2014 and replacement rates associated with consumption smoothing.

The current system results reflect the fact that many current pensioners were affiliates of the old system that was in place before the 1980 reform, and therefore do not accurately represent the results that would be generated under a system that was purely individual capitalization. Therefore, at the end of this section, we present projected replacement rates for the period 2025-2035.

### a) Pension Amounts

The pension amounts delivered by the system of individual capitalization are financed by the total balance accumulated in individual accounts plus the amount that corresponds to the value of the Recognition Bond, when relevant. For the

beneficiaries of the Solidarity Pension System, if their self-financed pension is lower than the maximum pension with Solidarity Contribution (currently \$291.778), then they will also receive a contribution from the Voluntary Pension Savings.

The pension amount will also depend on the type of pension modality that each affiliate selects. To compare the results of the different modalities, we used the average pension that can be expected at an affiliate's retirement to define the amount of the self-financed pension and used the average life expectancy according to the most recent mortality tables.

Furthermore, to assess pension amounts, we must take into account that current pensioners have had different work histories and contributory behavior during their working lives (different contribution density), which will affect the amount of their pension. In order to make the results more representative of the reality of the majority of pensioners, our analysis considers the median pension amount<sup>68</sup> rather than the average amount, given that, as is the case for income, distribution of pensions is asymmetrical.

<sup>67</sup> Pension systems use distributions within a generation and also between generations.

<sup>68</sup> The median in this case corresponds to the pension amount that divides the distribution of pensions in half, that is to say, the pension amount that a maximum of 50% of pensioners receive.

**Table 12. Median Pension by Brackets of Months for which the Affiliate Contributed (2007-2014)**

Bracket of months when affiliate contributed	Interval	Self-financed pensions			Self-Financed Pensions + APS		
		Women	Men	Total	Women	Men	Total
Low bracket (<=25%)	[1 - 35]	\$1.534	\$2.522	\$1.763	\$5.013	\$67.128	\$11.949
N		76.552	35.230	111.782	76.552	35.230	111.782
Medium low bracket (26% - 50%)	[36 - 146]	\$10.665	\$24.454	\$13.705	\$15.054	\$86.896	\$29.675
N		76.357	46.482	122.839	76.357	46.482	122.839
Medium high bracket (51% - 75%)	[147- 285]	\$40.001	\$89.212	\$62.613	\$50.919	\$118.661	\$92.803
N		62.301	60.415	122.716	62.301	60.415	122.716
High bracket (>75%)	[286 - 386]	\$220.845	\$239.682	\$229.179	\$222.941	\$244.357	\$232.792
N		54.675	72.737	127.412	54.675	72.737	127.412
No information	Affiliate contributed for 0 months	\$4.986	\$13.233	\$5.301	\$31.013	\$73.998	\$41.750
N		1.899	644	2.543	1.899	644	2.543
<b>Total</b>		<b>\$18.233</b>	<b>\$80.933</b>	<b>\$37.667</b>	<b>\$42.561</b>	<b>\$112.333</b>	<b>\$82.650</b>
<b>N</b>		<b>271.784</b>	<b>215.508</b>	<b>487.292</b>	<b>271.784</b>	<b>215.508</b>	<b>487.292</b>

1. Pensioners who were affiliated after 2008 are excluded.

2. Programmed withdrawal is defined as Expected Average Pension.

Source: the Commission's own calculations based on administrative data from the Superintendence of Pensions

The median value of old-age self-financed pensions between 2007 and 2014 was \$37,667, and \$82,650 when the APS is added.

As expected, this value differs according to the number of months that each pensioner contributed. For those with less than 35 months of contributions (about three years), the median self-financed pension amount is \$1,534 for women and \$2,522 for men. In contrast, those with more than 286 months of contributions (more than 23 years of contributions), can self-finance pensions exceeding \$220,000. In all cases, the APS contribution increases median pensions and is a much more significant support for affiliates who contributed for fewer months.

There is a significant gap between the pension amounts of men and women. Half of women receive pensions that, with the Solidarity Pension Contribution (APS), are equal to or below \$42,561. In contrast, half of the men receive pen-

sions of \$112,333. This is explained by the difference in the retirement age of women and the age at which they can access the benefits of the Solidarity Pension System. Since women can retire at 60 years old, the pension amounts estimated here do not allow us to see how much they would receive from the APS if they retired at 65, in cases where they met the eligibility requirements. If we only examine the pensions of women who are 65 and who are beneficiaries of the Solidarity Pension Contribution, half of them receive pensions of around \$89,398, well above the self-financed pensions and closer to the median pension of men.

The facts described above show the importance of highlighting the role of the Solidarity Pension System in increasing the pension amounts that are received by pensioners. When the APS is included into the averages of self-financed pensions of men and women, their pensions increase by 95% and a 251%, respectively.

## **b) Real Replacement Rates**

For a pension system to fulfill its objective of smoothing consumption, it must protect individuals from possible consumption shocks in their old age. To that end, the pension amounts have to be compared to some variable related to purchasing power during the active working stage or some minimum level of consumption for retirees. The replacement rate is calculated as the ratio between received pension and some measure of purchasing power.

Generally, the average taxable income over the course of an affiliate's working career—typically reported by the OECD and the ILO—or during some given time period is used as the variable representing purchasing power during the affiliate's working life. This section presents the replacement rate that affiliates received in the 2007-2014 period, using the affiliate's last income and their average income during the last 10 years of employment before retirement<sup>69</sup> as measures of purchasing power.

As with the pension amounts, the distribution of replacement rates is also asymmetrical—the average replacement rate is different from the replacement rate that most retirees receive. Therefore, below we present median replacement rates for the total number of pensioners between 2007 and 2014, categorized into different contribution brackets.

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<sup>69</sup> In this case, due to the availability of information, we used the average taxable income from the ten years prior to retirement as a basis for calculating the replacement rate.

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**Table 13. Median replacement rates according to number of months of contributions (2007-2014)**

Bracket of months when affiliate contributed	Interval	Self-financed pensions			Self-Financed Pensions + APS		
		Women	Men	Total	Women	Men	Total
Low bracket (<=25%)	[1 - 35]	4%	5%	4%	21%	128%	64%
N		20.877	11.588	32.465	20.877	11.588	32.465
Medium low bracket (26% - 50%)	[36 - 146]	10%	23%	13%	15%	69%	33%
N		43.449	29.493	72.942	43.449	29.493	72.942
Medium high bracket (51% - 75%)	[147- 285]	23%	45%	33%	27%	57%	42%
N		51.797	54.435	106.232	51.797	54.435	106.232
High bracket (>75%)	[286 - 386]	36%	55%	46%	37%	59%	48%
N		53.819	71.963	125.782	53.819	71.963	125.782
No information	Affiliates contributed for 0 months	7%	41%	9%	170%	53%	139%
N		369	29	398	369	29	398
<b>Total</b>		<b>24%</b>	<b>48%</b>	<b>34%</b>	<b>31%</b>	<b>60%</b>	<b>45%</b>
<b>N</b>		<b>170.311</b>	<b>167.508</b>	<b>337.819</b>	<b>170.311</b>	<b>167.508</b>	<b>337.819</b>

1 Pensioners who were affiliated after 2008 are excluded.

2 Programmed withdrawals are defined as Average Expected Pension

Source: the Commission's own calculations based on administrative data from the Superintendence of Pensions

The median replacement rate of self-financed pensions over the income from the last 10 years prior to retirement is 34% for all pensioners, while the average replacement rate is 51%. The greater the number of months during the affiliate contributed, the greater the median replacement rate is. In the lowest bracket, which includes pensioners who contributed for less than 35 months, 50% of affiliates receive replacement rates that are equal to or less than 4%, while for the highest bracket, who have more than 386 months of contributions, half of the pensioners get replacement rates that can reach 46%.

By including the contribution from the Solidarity Pension Contribution, the median replacement rate increases for total pensioners, reaching 45%.

There are also significant gaps between the median replacement rates as compared to affiliate income from the last 10 years for men and women, both in the total number of pensioners, and in the different brackets of contributions. While the median replacement rate for self-financed pen-

sions of women is 24%, the median for men is 48%. By including the APS in both cases, the median replacement rates increase to 31% for women and to 60% for men. The smaller increase in the replacement rate for women is again because when pensions are estimated, many women still do not meet the requirements to qualify for the APS. If we consider only women who are over 65 and who meet the income requirements to qualify for the Solidarity Pension System, the median replacement rate increases from 13% to 90%.

### c) Projected Replacement Rates

The statistics above reflect the current pensions that the pension system delivers. From the group of current pensioners, a large number were affiliates of the former system who were transferred into the system of individual capitalization. Thus, the current pension amounts and the replacement rates do not accurately represent the results generated by a system of purely individual capitalization. It is useful, therefore, to project the system's performance into the future. Once

we project future pensions, we can use different measures of adequacy to assess how the individual capitalization system in Chile fulfills the desired objectives of a pension system.

The first affiliates to have contributed into this system during their whole working life will begin to retire in the year 2025. To project the results for this generation and the next, we estimate their profiles of future earnings and participation in the labor market, which along with the history of the

pension system's performance described above, allows us to estimate the accumulated balance and pension amount that would be received by each affiliate.

As we did in the previous section, we present below the median replacement rates projected for different contribution brackets.

**Table 14. Median replacement rates projected according to months of contributions (2025-2035)**

Bracket of months when affiliate contributed	Interval	Self-financed pensions			Self-Financed Pensions + APS		
		Women	Men	Total	Women	Men	Total
Low bracket (<=25%)	[1 - 190]	3,30%	4,70%	3,80%	34,80%	34,50%	34,70%
N		356.743	154.915	511.658	356.743	154.915	511.658
Medium low bracket (26% - 50%)	[191 - 299]	8,30%	11,80%	9,60%	31,00%	34,40%	32,00%
N		309.922	202.596	512.518	309.922	202.596	512.518
Medium high bracket (51% - 75%)	[300 - 399]	19,30%	24,70%	21,90%	35,90%	42,10%	39,80%
N		229.918	280.222	510.140	229.918	280.222	510.140
High bracket (>75%)	[400 and more ]	31,00%	42,30%	38,90%	36,80%	49,20%	46,60%
N		106.547	398.471	505.018	106.547	398.471	505.018
<b>Total</b>		<b>8,30%</b>	<b>24,70%</b>	<b>15,30%</b>	<b>34,10%</b>	<b>41,00%</b>	<b>37,20%</b>
<b>N</b>		<b>1.003.130</b>	<b>1.036.204</b>	<b>2.039.334</b>	<b>1.003.130</b>	<b>1.036.204</b>	<b>2.039.334</b>

1 Pensioners who were affiliated after 2008 are excluded

2 Los Retiros Programados se definen como una Pensión Promedio Esperada

Fuente: Elaboración propia en base a datos administrativos de la Superintendencia de Pensiones

50% of pensioners between 2025 and 2035 would get replacement rates at or below 15% of their average income over the last 10 years prior to retirement.

As was the case for the current replacement rates, the greater the number of months for which affiliates contributed, the higher the average rate of replacement. In the lowest bracket, which includes pensioners who contributed for fewer than 190 months of contributions, the median replacement rate is 3.8% while for the highest bracket, which includes pensioners who have more than 400 months of contributions, the replacement rate is 38.9%.

The contribution from the APS increases the median replacement rate to 37.2% for total pensioners, and to 34.1% for women and to 41% for men. Although the contribution amount from the Solidarity Pension Contribution will be greater for future generations of pensioners, the total replacement rate, including that contribution, is expected to be lower than the current average rate of replacement of existing, irrespective of the contribution bracket.

#### **d) Comparative replacement rates**

As point of comparison of the adequacy of pensions in Chile, we examined the estimates from the Organization for Economic Cooperation and Development, the OECD.

The OECD estimates theoretical replacement rates for all its members, based on representative agents with a contribution density of 100% and based on the main rules of each system as well as on different scenarios for the observed returns, inflation and wage growth.

In the latest edition of the report "Pensions at a Glance" in 2013, the organization estimates that in Chile the gross and net replacement rates<sup>70</sup> are equal to 41.9% and 51.8% for men and 33% and 41.25% for women. Using this same methodology, the gross and net replacement rates of all member countries is, on average, equal to 54.4% and 65.8% for men and 53.7% and 65% for women.

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70 The net replacement rate includes the payment of income taxes and contributions made to the health and pension systems.

Given that these estimates are mainly based on the assumption of a representative agent that contributes over the course of their entire working life, the results could be interpreted as the maximum replacement rate at which each country can aspire to rather than as real replacement rates.

The study that the Commission requested of the OECD on replacement rates<sup>71</sup>, replicates the previous exercise for individuals who delay their entry into the labor market and therefore have lower contribution densities. The following Table presents the average net replacement rate of OECD countries, excluding Chile, of men and women for different contribution density brackets. The gap between the replacement rates estimated for Chile and those estimated for OECD countries according to different contribution density brackets is included in the last two columns of the Table.

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71 Study on replacement rates and other issues related to the Pension System, (OECD, 2015).

**Table 15. Average net replacement rates in OECD countries (excluding Chile), according to contribution densities and sex.**

Brackets of Months of Contributions	OECD				Gap with Replacement Rates in Chile (percentage points)	
	Men		Women		RR Men	RR Women
	Average Density	RR	Average Density	RR		
Low bracket	13,60%	30,90%	13,30%	30,90%	-10,8	-11,3
Medium low bracket	35,20%	38,50%	35%	38,90%	-12,9	-15,0
Medium high bracket	67,6	52,10%	67,50%	51,70%	-16,4	-22,8
High bracket	89,20%	61,50%	89,20%	61%	-17,8	-26,3
Whole Career	100%	66,10%	100%	65,60%	-17,9	-27,7

Source: Study on replacement rates and other issues related to pension systems, requested of the OECD by the Commission on Pensions (2015)

For both men and women, the average net replacement rate increases as the number of months of contributions increases. In the low bracket, for contribution densities of about 13%, average replacement rates in OECD countries are equal to 30.9%, with no difference between men and women. For people with contribution densities of 67%, the net replacement rate it is on average equal to 61.5% for men and 61% for women.

To evaluate the performance of the Chilean Pension System as compared to replacement rates in the OECD countries, the right side of Table 15 presents the difference between the OECD replacement rates for men and women and the rates in Chile, according to different contribution density brackets.

These numbers allow us to conclude that across all brackets and for both men and women, the net replacement rates in Chile are lower than those of the OECD member countries. However, the magnitude of the gap changes depending on the density of contributions. For the lowest bracket, for example, the gap is around 11 percentage points, while in the highest bracket (where contribution density is around 89%) the gap is 17.8 percentage points for men and 26.3 points women.

#### e) Other measures of pension adequacy

Another way to assess the adequacy of pensions is to estimate replacement rates with respect to a measure of minimum consumption. To measure this, we can compare the pensions paid out by the pension system between 2007 and 2014 (including the amount of APS, as appropriate), to the poverty line<sup>72</sup> and to the minimum wage<sup>73</sup>. The results of these two indicators show that 79% of pensions are below the minimum wage and 44% are below the poverty line. If the above exercise is performed considering only the beneficiaries of the SPS, a smaller proportion of pensions fall under the poverty line, 14%, while the percentage of pensions that do not exceed the minimum wage is higher, reaching 93%.

<sup>72</sup> This corresponds to the minimum income per person to meet basic needs. This amount is based on the cost of a basic basket of goods. Currently, according to the Ministry of Social Development, its value is \$66,084 in the country's urban areas.

<sup>73</sup> See Background Chapter 4 of the Final Report.

In the previous two measures of replacement rates, there are gaps between men and women. While 59% of women receive pensions under the poverty line, 26% of men find themselves in the same situation. If one considers only the beneficiaries of the APS for the same period, the situation is less dire: 22% of women and 9% of men receive pensions below the poverty line.

The same thing happens when the replacement rates for men and women are compared to the minimum wage. When considering the total number of pensioners, 85% of women and 72% of men receive initial pensions that are less than minimum wage. With respect to beneficiaries of APS, the same comparison reveals that 95% of women and 92% of men receive pensions that are below the minimum wage, which is to be expected given the amount of the Maximum Pension for Solidarity Contributions.

#### **f) Alleviating Poverty in Old Age**

The Solidarity Pension System fulfills an important role regarding income poverty relief: around 60% of people with access to the solidarity pension system belong to families whose incomes fall below the poverty line. From these groups, 28% of beneficiaries belong to a family with no income at all<sup>74</sup>.

During December 2014, the solidarity pension system granted 1,281,628 benefits. 45.5% (583,202) of these were from the PBS, and 54.5% (698,426) were from the APS. The benefits associated with this system are mainly for women. In December 2014, 66.5% of the PBS pensions and 57.6% of the APS pensions were granted to women.

Using an alternative targeting measure as a basis for analyzing the current benefit allocation, the results show that both the PBS and the APS are appropriately targeted. Using the traditional concept of a household's per capita income to analyze individuals and households (based on the data of the 2011 CASEN survey), we can see that in the case of the PBS, 52% of beneficiaries belonged to the 20% of the population with the lowest income, and 87% of the beneficiaries

were in the 60% of the lowest income population. Generally, 96% of people who report receiving benefits from the solidarity pension system in the 2011 CASEN survey are part of a household belonging to the poorest 60% of the population, according to the Technical Targeting Instrument (Instrumento Técnico de Focalización) used to allocate benefits.

Based on an analysis of the first three years since the implementation of the 2008 Reform, the data shows that the reform has contributed to relieving poverty and indigence among elderly people. If the reform had not been carried out, the rate of poverty would have been 9.6% for people aged 65 and over, in comparison with the observed rate measured in the 2011 CASEN survey, which was 7.5%. The 2008 Reform had a positive impact on indigence or extreme poverty for people aged 65 and over. In 2011 the rate amounted up to 1.6% in contrast to the 2.1% estimated, if benefit had not been received.

Other evaluations of the 2008 Reform concluded that pension amounts increased due to its implementation, particularly among women.

For example, Attanasio, Meghir and Otero (2011) project the impact of the first years of the reform and come to the conclusion that for workers retiring before 2015, the self-financed social security savings will increase by an average of 0.6% and the final pension amount will increase by an average of 15%. This effect is different when we segregate by gender. The increase in the average pension for women is 56% larger than the increase for men. The same study found that the reform decreases the ratio of women with pensions below the poverty line by 32 and 36 percentage points for the cohorts of 1940 and 1960, respectively.

Joubert and Todd (2011) confirm these results, based on a dynamic long-term model for labor participation and savings decisions. They conclude that levels of poverty are significantly reduced among households that receive the PBS (households with an income below \$500,000 per year). Nevertheless, the reform also slightly increases the poverty rate among younger age groups, due to the labor disincentive.

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74 See Background Chapter 4 of the Final Report.

The importance of the solidarity pension system regarding poverty relief could be undermined if adequate readjustment mechanisms are not used to adjust the amounts of benefits. Currently, the amount of the Basic Solidarity Pension for old-age represents less than 40% of the minimum wage, and barely surpasses the urban poverty line.







**REGARDING THE  
NATURE OF THE  
MODIFICATIONS THAT  
THE CHILEAN PENSION  
SYSTEM REQUIRES:  
THE COMMISSION'S  
DISCUSSION ON THE  
GLOBAL PROPOSALS**

## ► VI. REGARDING THE NATURE OF THE MODIFICATIONS THAT THE CHILEAN PENSION SYSTEM REQUIRES: THE COMMISSION'S DISCUSSION ON THE GLOBAL PROPOSALS

There is a consensus within the Commission on the necessity of increasing the pensions of current retirees, and of creating the conditions that would allow future pensioners to access better pensions.

There is also a consensus that the Commission's assessment of the current pension system in Chile demonstrates that to achieve this objective, the system must be reformed. What, however, is the nature of these reforms? How structural do the changes need to be?

The Commission, in its plenary sessions (with all its national and international members), addressed these questions. In the meeting held on May 12 and 13 in 2015, the full Commission agreed to categorize the approaches that individual Commissioners had previously explored into three main positions (referred to as Global Proposals). Using this categorization, individual members of the Commission developed each of the global proposals to produce versions that could be discussed in depth in the next plenary meeting in late July.

The three positions were called global proposals A, B and C, respectively. In summary, each proposes the following:

- » Global Proposal A fulfils the presidential mandate by building on the 2008 reforms, by strengthening solidarity benefits, improving the savings element and gender equity, while maintaining critical incentives for savings, investment, and economic growth that allow for the financing of future pensions.
- » Global Proposal B seeks to increase the legitimacy of the system and integrate the principles of social security by creating a component of social security based on solidarity between members and between generations.
- » Global Proposal C seeks to respond to the views expressed during the public participation process, to reform the system to one that is purely pay as you go.

At the plenary meeting of the Commission held in late July of 2015, the 24 Commissioners expressed their support for the three global proposals identified above.

Global Proposal A was supported by 12 Commissioners: Orazio Attanasio, Nicholas Barr, David Bravo, Martin Costabal, Carlos Diaz, Costas Meghir, Olivia Mitchell, Carmelo Mesa-Lago, Ricardo Paredes, José Luis Ruiz, Jorge Tarzján and Sergio Urzúa.

Global Proposal B was supported by 11 Commissioners: Cecilia Albala, Fabio Bertranou, Hugo Cifuentes, Regina Clark, Christian Larrain, Veronica Montecinos, Joakim Palme, Marcela Rios, Claudia Robles, Claudia Sanhueza and Andras Uthoff.



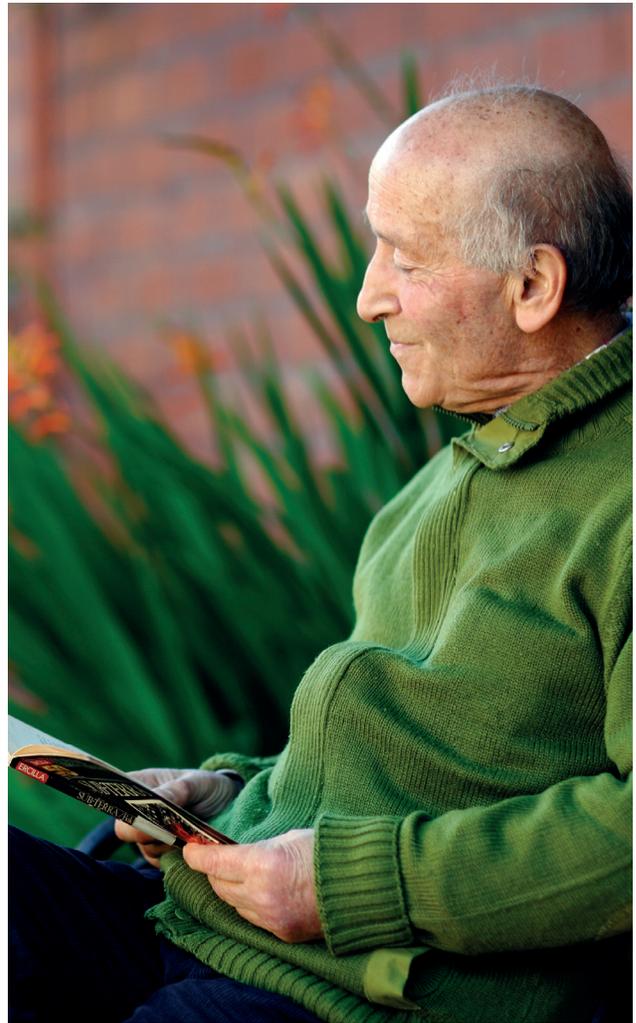
Global Proposal C was supported by 1 Commissioner, Leokadia Oreziak.

As a result, we can say that with respect to this important discussion, the Commission:

- » Does not support Global Proposal C, which aims to replace the current pension system with a pay as you go system.
- » With respect to the other global proposals, 12 Commissioners supported Proposal A and 11 supported Proposal B, which is why the Commission does not consider that the discussion is solved.

Given this, the Commission agreed that its final report would:

- » Present an analysis of all three global proposals. For the purposes of this analysis, condensed versions of the proposals can be found in Section VI and are detailed fully in Appendix 4 of this report;
- » Explain why the proposal to return to a pay as you go system is not supported by the Commission (the explanation is laid out in Section VI); and,
- » Summarize the debate within the Commission regarding the proposals A and B.



## A. Description of the Global Proposals

### 1. Global Proposal A<sup>75</sup>

#### “IMPROVING BENEFITS, ADEQUACY, COVERAGE AND EQUITY IN CHILE’S PENSION SYSTEM”

##### I. THE STRATEGY

1. Proposal A is designed to strengthen the solidarity pension system, a desirable objective in its own right; to increase gender equality, also desirable in its own right; and to maintain the saving element, to enable the system to keep its pension promises.
2. **CHILE’S 2008 REFORM WAS FUNDAMENTALLY IMPORTANT.** Until 2008, the pension system was based mainly on individual savings through AFP accounts and thus did not provide adequate benefits for people with low lifetime earnings or incomplete contribution histories. Thus Chile did not have a pension system, but only part of a system. The 2008 reforms rounded and completed the system by creating the structure of solidarity benefits.
3. Those reforms, however, left unfinished business, including low pensions, low coverage, high charges, gender inequality and lack of trust in the system.
4. **FINANCING BENEFITS FROM THE SAVINGS ELEMENT IS NOT THE ANSWER.** One suggested approach is to use AFP contributions and perhaps also assets to finance higher pensions today. Proposal A rejects that approach because it solves problems today at the expense of workers and pensioners in the future.
5. The reason is straightforward: using contributions to finance current benefits reduces saving at a time when, because of declining fertility, there will be fewer workers in the future. Maintaining consumption by pensioners over longer retirements depends on growing output. But a smaller workforce will reduce the growth of output unless offset by other factors. The appropriate response to a smaller

workforce is to make each worker more productive through investment in human capital – more education and training – and physical capital.

6. Any policy that reduces saving, by exerting downward pressure on investment, is entirely the wrong way to go. **The distinctive feature of the strategy in Proposal A is that it finances broadly the same increase in benefits as other Proposals but finances the increase through government spending and a new employer contribution. By reducing saving less, Proposal A improves the prospects for future living standards, and hence the ability to finance promised pensions in the future.**
7. **STRENGTHENING PAYG AND IMPROVING THE SAVINGS ELEMENT.** For these reasons, the best way forward is to build on the 2008 strategy.
8. Specifically, the Proposal fulfils the Presidential mandate in the following ways:
  - » It addresses the legitimacy of the system:
    - By strengthening the solidarity pension (the PAYG element) by significantly increasing benefits and extending coverage to more people; and
    - By accommodating options for radical reform of the saving element.
  - » It increases low pensions and increases replacement rates and, by doing so through the solidarity pension, reduces the dispersion of replacement rates. These parts of the Proposal particularly benefit women.
    - It introduces a new employer contribution to the Solidarity Fund.
    - Through the combination of tax finance and the employer contribution, the Proposal incorporates both intergenerational transfers and solidarity within the system through redistribution from higher- to lower-income people.

<sup>75</sup> Proposal supported by commissioners Orazio Attanasio, Nicholas Barr, David Bravo, Martín Costabal, Carlos Díaz, Carmelo Mesa-Lago, Costas Meghir, Olivia Mitchell, Ricardo Paredes, José Luis Ruiz, Jorge Tarzijan, and Sergio Urzúa.

- The Proposal is fiscally responsible. It creates a system that will stand the test of time – a system that pays higher benefits to today's pensioners but can also pay the pensions it promises to future generations.

## II. KEY ELEMENTS OF PROPOSAL A

### II.1. Changes to the solidarity noncontributory pillar

9. **BENEFITS.** Proposal A strengthens the solidarity pension system.

- It merges the PBS and APS into a single universal benefit, the University Solidarity Pension, covering at least 80% of the retired population.
- It increases the solidarity benefit by 20% for a person with no AFP pension.
- It introduces a matching solidarity element for AFP pensions and thus boosts pensions in the middle income ranges and strengthens incentives to formality.
- It tapers the solidarity benefit for those receiving higher AFP pension benefits.
- It provides actuarially fair incentives for those who delay the start of benefit.

10. **Finance.** The Proposal provides for new sources of revenue for the solidarity pillar:

- General revenues of 0.2% of GDP from taxes immediately and into the future.
- A new employer contribution of 2% of earnings up to the contribution ceiling.
- A wider definition of covered earnings.

11. **Timing.** Benefit and tax increases to take place over the next 5 years.

### II.2. Changes to the AFP pillar<sup>76</sup>

<sup>76</sup> Sections II.2. and II.3 describe changes that improve the operation of the saving element. As discussed in section II.7, the strategy is compatible also with more radical reform of the saving element, including plans that allow wider risk sharing.

12. Continue workers' contribution rates at 10% of covered earnings, but expand the definition of covered earnings to include remuneration now excluded.

13. Include a new 2% matching contribution from employers, based on the broader definition of covered earnings.

14. Raise the contribution ceiling on covered earnings and index it to wages.

### II.3. Changes to the AFP marketplace

15. Establish a state-run AFP operated under the same rules as other AFPs, with an institutional setup that guarantees that it is completely independent and self-financing.

16. Periodically, participants would automatically be re-enrolled in the age-appropriate default fund of their AFP, determined by auction to have the lowest charges.

17. AFP costs and barriers to entry could be eased by decreasing the AFP reserve rate.

18. Modify multi-funds to reduce risk, and reduce the number to 3 instead of 5. One of these should be a simple option with passive fund management.

19. Hold periodic auctions for affiliates of AFP licenses, with all licenses at stake.

20. The programmed withdrawal should be eliminated, with annuitization compulsory except for very small accumulations. Annuitization should be based on unisex life tables.

### II.4. Changes in retirement ages

21. This element addresses an important element of sustainability, consonant with trends in other OECD countries.

22. Move men and women to the same minimum pension age, initially age 65.

23. An independent actuarial commission should index the minimum pension age to changes in life expectancy in the future.

## II.5. Changes to improve gender equity

24. Unisex mortality tables should be used for annuitization.
25. The pension contributions of husband and wife and other formal partnerships should be shared on a year-by-year basis, with 50% of the husband's contributions going into his wife's accumulation and vice versa.
26. Add a tax-financed contribution to the AFP account for people caring for young children and the elderly<sup>77</sup> for each year of caregiving activity.

## II.6. Other elements

27. Improve contribution densities through better enforcement.
28. Reduce disincentives associated with social programs.
29. Promote financial education and literacy programs.

## II.7. Looking ahead

30. It is mistaken to think that maintaining the saving element makes Proposal A a conservative strategy. Though maintaining saving is central, saving does not necessarily have to be organized via the AFP system, but can be arranged in many different ways. The strategy including, importantly, the introduction of a government-organized AFP, is compatible with multiple ways of organizing saving, including:
  - The Thrift Savings Plan for US federal civil servants, a simple, cheaply-managed savings plan with centralized administration and a default option with passive fund management.
  - A pension financed from a sovereign wealth fund (Norway is the closest example).
  - Collective defined-contribution occupational pensions, as in the Netherlands.

Thus Proposal A is designed to accommodate radical reform.

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<sup>77</sup> One Commissioner dissents from the idea of contributing in respect of care of the elderly.

## 2. Global Proposal B<sup>78</sup>

### Summary

*Proposal B transforms the current solidarity pension scheme into a social security component, which will play a central role in the pension system with tripartite funding. The new pension system will be made up of citizens' social security accounts (which could be in the form of notional accounts), and will maintain (and expand the coverage of) the basic solidarity pension, as well as the individual capitalization accounts for people with income levels above \$350,000 CLP. The proposal will increase the pensions of current pensioners by creating a solidarity fund with contributions from workers, employers and the state. The amount and coverage of basic solidarity pensions will be increased until it covers 80% of the population. The new social security component will be financed by a 10% contribution from all affiliates, up to \$350,000 CLP, and a matching contribution from employers and the state<sup>79</sup> that reflects each worker's contributory efforts. The new social security component will facilitate the inclusion of self-employed workers, improve the current mechanisms that seek to alleviate inequalities between men and women, and introduce solidarity among and across the generations in the system.*

### Strategy based on the presidential mandate

The changes introduced by the 2008 reform were not, as the President has requested of this process, intended to legitimize a pension system. These changes advanced the creation of a solidarity pillar to alleviate poverty by extending the coverage of the system's non-contributory component, but they were not enough to legitimize the pension system, particularly in regards to the contributory component, which is designed as a system of individual capitalization accounts. The coverage and level of contributory pensions has remained inadequate. As an overall result of the reform, the current system is still delivering low pension amounts and high fees; it lacks solidarity among affiliates, particularly in terms of gender, impacting women negatively; affiliates continue

to be responsible for complex financial decisions that can strongly impact the amount of their pensions; and the overall funding lacks employers' contributions.

Our proposal deems it essential to reestablish the pension system's legitimacy by constructing a new social welfare contract. This consists of creating a social security system that is in line with the globally recognized principles of social security. The new social security component of the pension system will reduce the excessive risk exposure of affiliates, create the foundation for a guaranteed level of income in workers' old-age, increase the public's willingness to accept specific changes to the system's parameters, allow for more risk diversification and for solidarity in the redistribution of its resources, and will also create incentives for affiliates to increase contributions. The new proposed structure will decrease gender-based inequalities in the labor market and will help change the cultural and social distribution of roles between men and women which are currently exacerbated by the system, and also facilitate the inclusion of self-employed workers. By introducing a modality of matching contributions, this proposal takes responsibility for the basic problem of low contribution density, since it associates the solidarity contribution with the affiliate's own contributory efforts.

Likewise, the individual capitalization accounts pillar, which will remain in place for workers that earn more than \$350,000 CLP, requires substantial adjustment in order to construct a mixed pension system which would improve pensions (both in their coverage as well as in their amounts), creating more certainties regarding the right of workers to social security.

In both components, workers keep the right to their current accumulated funds.

78 Proposal supported by commissioners Cecilia Albala, Fabio Bertranou, Hugo Cifuentes, Regina Clark, Christian Larraín, Verónica Montecinos, Joakim Palme, Marcela Ríos, Claudia Robles, Claudia Sanhueza, and Andras Uthoff.

79 Doubling the worker's efforts.

## The proposed system

The system we propose has two components.

1. A non-contributory component: the Basic Solidarity Pension. Every affiliate who is above 65 years old or disabled and who does not belong to the wealthiest 20% of the population will be eligible for this uniform and adjustable benefit.
2. A contributory component that separates the contributions in two modalities:
  - a. The contributions from those people who contribute less than \$350,000 CLP and the first \$350,000 CLP contributed by people who contribute more than that amount will go to a social security component, managed as a collective solidarity fund. This solidarity fund will include each peso that affiliates deposit into their citizen's social security accounts, which will then be matched by contributions from employers and/or the state. The system will be financed via the contribution of 10% from all affiliates, up to \$350,000 CLP, and via the matching amounts contributed by employers and the state. The matching resources will help increase the pension amounts of current pensioners based on what they contributed during their working lives. The balance is accumulated in the solidarity fund. In summary, the benefits that an affiliate receives will be determined by the results of the collective capitalization scheme and by the record of what the affiliate contributed into their citizen's social security account<sup>80</sup>. At the moment of their retirement, affiliates will receive a benefit that is actuarially equivalent to their individual contributions, capitalized with the rate from the solidarity fund; and with the matching resources they will receive an additional benefit based on different eligibility criteria for men and women of different income groups. Thus, the system introduces an incentive for contributing and for solidarity among affiliates.

- b. The contributions for income beyond the first \$350,000 CLP will be transferred to the AFPs chosen by each affiliate. These AFPs will manage the funds as they currently do, and will report the amount of each individual's contributions to a centralized welfare entity in charge of affiliation, collection and record keeping. The AFPs will be responsible for the management of the funds, allowing affiliates to choose among AFPs and the funds they manage.

The system we propose delivers three benefits to affiliates:

- a. The Basic Solidarity Pension, a uniform benefit financed through non-contributory resources;
- b. The pension from the social security component, which is a combination of benefits from defined contributions according to the collective capitalization rate of the contributions based on incomes of less than \$350,000 CLP, and matched up to a certain limit by solidarity resources (from the employer and state).
- c. The pension from the individual capitalization accounts pillar, based on affiliates' contributions to the AFPs for income over \$350,000 CLP.

The system we propose creates two new institutions.

» A social security entity, in charge of:

- Affiliating and collecting contributions from citizens, employers and the state.
- Delivering the contributions based on incomes less than \$350,000 to a Solidarity Fund in charge of the Social Security Component, and the contributions for income over \$350,000 to the AFPs chosen by each affiliate.
- Keeping a record and informing the affiliates of the status of their accounts regarding their contributions to the social security account and/or the AFPs, and an estimate of the expected benefits they will receive from each modality.

<sup>80</sup> The citizens' social security account is also referred to as a "notional account", and it refers to the traditional record of workers' contribution records, in addition to the contributions matched by the employers and/or the state, and the interest rate agreed upon by society for the collective fund.

» A collective Pension Fund, in charge of:

- Investing in a collective and informed manner the workers' contributions that go to the social security component;
- Managing the funds from the amounts matched by employers and state, in order to pay pensions and manage the balance in similar form as the contributions of the affiliates.

The system has four critical points to guarantee its stability:

1. The threshold of taxable income based on which contributions will go to the social security component. The cut-off at \$350.000 CLP was chosen to establish a threshold that would ensure that the benefit awarded by the social security component would be equal to the minimum wage (which would be equivalent

to a replacement rate of 70%). This may vary according to the median of taxable income at the moment that the threshold amount is calculated.

2. The formula for matching each person's contributions (which in the current system is referred to as the "self-financed pension") with resources stemming from employers' and the state's contributions.
3. The people benefiting from PBS, who do not belong to 20% of the population with the highest income.
4. The single social welfare entity, which would allow the system to have lower costs associated with the management of the fund (i.e., in Sweden this cost reaches 0.41% of the salary). For the proposal to be implemented, a new institution must be created, possibly built on the one established by the 2008 Reform.

 **Table 16. Summary of the organization, benefits and financing of a Mixed System of Pensions**

		Non-contributory	Contributory	
			Social Security Component	Individual Capitalization Accounts
Benefits destined for (by income group)	People who do not contribute	PBS	-	-
	People with income below \$350,000	PBS	PSS	-
	People with income above \$350,000	PBS (Excluding 20% of the population with the highest income)	PSS	PCI
Funding		General income	Personal and employer's contributions for salaries up to \$350.000 CLP. Contributions from the state originating from general income	Personal contributions for income above \$350.000 CLP
Management of accounts, funds and benefits		Entity managing the social security component	Entity managing the social security component	Entity managing the social security component
			Solidarity Fund	AFPs – Insurance companies
			Collective capitalization (Similar to FRP)	Individual capitalization accounts

1. PBS: Basic Solidarity Pension
2. PSS: Social Security Pension
3. PCI: Individual Capitalization Accounts Pension
4. FRP: Pensions reserve fund

### 3. Summary of Global Proposal C<sup>81</sup>

Global Proposal C suggests replacing the current system with a pay-as-you-go system and assumes that current AFP affiliates will transfer their contributions and funds to the new PAYG system, in exchange for a better pension that is defined, that will last for the affiliate's life and that is non-discriminatory. The PBS and the very low pensions of the former PAYG system will be immediately increased by at least 100%. The full contribution amount will be used as income to pay contributory pensions without using state subsidies. The effective retirement age (currently 70 years old) will be reduced to its legal limits (60 and 65 years old), and remain there (in an alternative scenario the age would gradually be increased by two years beginning in 2030). On average, pension benefits will increase by 75% to 100%. Contribution rates will not increase until 2035, and then increase to 25%. The proposal will not require any additional taxes, on the contrary, since it ends the direct and indirect cash subsidies, it will generate fiscal savings on the order of 1.8% of GDP.

The main elements of the Global Proposal C are summarized below:

#### 1. Changes to the Non-Contributory Solidarity Pillar

The non-contributory pillar, financed from general taxation, will be reduced to the Basic Solidarity Pension ("Pensiones Básicas Solidarias"), the PBS, the holdovers from the old PAYG system and other pensions paid by Instituto de Previsión Social (IPS). The number of beneficiaries in the non-contributory pillar will decrease rapidly, from the current 63 percent of the elderly to 40 percent in the 2020s. The proposal allows for an immediate rise in non-contributory pensions, because the end of direct and indirect subsidies to contributory pensions, including the Top-Up Welfare Complement (the APS), will generate fiscal savings of 1.8% of GDP per year, from the very start. An increase should be considered because the minimum contributory pensions will be immediately raised at least by 100%, and subsequently increased according to wages, so a similar criteria should be applied to non-contributory solidarity pensions and very low old PAYG pensions, starting from the first year.

#### a) Financing

- i. New financing from general taxes is not needed either immediately or in the future.

Additional taxation is not required; on the contrary, this proposal generates an immediate fiscal surplus of 1.8 % of GDP per year, by ending all direct and indirect subsidies to contributory pensions. In addition, it generates further savings by rapidly reducing the number of non-contributory pensions.

- ii. No new employer contribution

The proposal does not consider any employer contribution for non-contributory pensions, apart from general taxation.

#### b) Benefits

- i. Universal affluence test for all benefits from this pillar

The contributory pillar will cover 60% of the elderly —financed exclusively from contributions, with no State subsidies— and consequently, the non-contributory system will be limited to the 40% of seniors that have the lowest incomes, from the 2020s on. Rather than means or affluence tests, beneficiaries of the non-contributory pillar should be targeted using a simple selection criteria, such as: they receive a pension that is lower than minimum contributory pension or, for example, they are not affiliates of the contributory system.

- ii. At least 100% initial raise in the Basic Solidarity Pension (PBS), and subsequent increases according to rise in wages.
- iii. The Top-Up Welfare Complement (APS) is terminated, because contributory pensions will be financed exclusively from contributions.

#### c) Projected changes over time associated with the proposal

Benefits will increase as soon as possible. There will not be any increase in taxes.

<sup>81</sup> Proposal supported by commissioner Leokadia Oreziak

The PBS is increased initially by at least 100%, as some very low pensions from the old PAYG system will also be increased; subsequently, all non-contributory pensions are increased annually according to wages.

#### **d) Impact on Poverty in Old Age**

The impact of the proposal in reducing poverty in old age is very significant, because from the very start it doubles the amount of solidarity pensions and raises very low pensions from the old PAYG system, in addition to at least doubling lower contributory pensions.

## **2. Changes to the Contributory Pillar (the AFPs and individual capitalization scheme are terminated)**

### **a) Financing**

Contributory pensions will continue to be paid at the current level until 2035. The full amount of contributions will be used as revenue to pay contributory pensions from a new PAYG scheme, with no state. The pension fund will be used as a buffer to avoid or minimize, and delay for decades, any increase in legal retirement age or contribution rates, and there will be a significant amount of residuals that will be kept in reserve, in all scenarios. All monetary subsidies to contributory pensions, including the APS, will be terminated immediately. Employers will pay all later increases in contributions.

### **b) Benefits**

Initially, i) the real retirement age will be reduced to legal limits (65 and 60 years old), and then either not changed at all, or, in a second scenario, then raised gradually by only two years starting in 2030; ii) average pensions will increase by between 75 and 100%, depending on scenarios, and subsequently increased annually in line with wages; iii) contribution rates will not be raised until 2035, and then be increased to reasonable levels (all increases will be paid by employers); iv) direct and indirect monetary subsidies will be terminated immediately, generating yearly fiscal savings of 1.8% of GDP; v) the number of non-contributory pensions will be rapidly reduced from the current 63% of elderly, to 40 % in

the 2020s, diminishing overall fiscal expenditure in civil pensions from the current 3.9% of GDP to a range of 1.6 to 1.9 % in the 2020s.

### **c) Other points**

- i. The proposal is politically viable because distribution of income will improve considerably and this will increase public trust in the pension system in particular and institutions in general. This improvement will be due to the fact that;
- ii. The proposal terminates the capitalization scheme, which under the pretense of being a pension system, is in fact a mechanism of transferring an ever increasing part of wages and general taxation to the financial markets, never to be returned because it always generates a huge surplus from the difference of the contributions received and the benefits paid.
- iii. When fiscal expenditures on civil pensions are taken into account, the proposal implies a significant increase in net national savings, the accumulated 2014 to 2052 present value of which is equivalent to three times the GDP in 2013.

## **B. Why doesn't the Commission support a proposal to transform the pension system into a pay as you go system?**

Of a total of 24 Commissioners, only one Commissioner supported Proposal C, which proposes replacing the current system with a pay as you go (PAYG) system. Why didn't the Commission as a whole endorse the proposal to move to a pay as you go system? The commissioners' main reasons for opposing the proposal included:

- a) Proposal C transfers worker-owned contributions and savings to the PAYG system, without any compensation for taking their individual accounts;
  - b) The proposal requires an abrupt and large increase in contributions/taxes at the time that the reserves are depleted;
  - c) Moving to a full-PAYG reduces savings and therefore investment, which is extremely problematic when the labor force is facing a decline;
  - d) The assumptions that the proposal makes are overly optimistic: increases in the contribution rate and the retirement age that are not feasible, optimism with regards to increasing labor formality and conservative assumptions with regards to the coverage of seniors. These assumptions produce a parametric reform to make the system meet the proposal's objectives but the bases of these assumptions are outside of what can be realistically expected from the Chilean labor market.
  - e) The problematic assumptions described in d), cast doubt on the financial sustainability of proposal C.
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## C. Counter-arguments to Global Proposals A and B

The arguments made by the 12 commissioners who supported proposal A over proposal B are summarized as follows:

*Proposals A and B broadly suggest the same increase in benefits. The fundamental difference lies in how each proposal seeks to finance the increase. Proposal A is designed not only to pay higher benefits now but also to ensure the ability of the system to pay promised pensions in the future. There are four sets of objections to proposal B:*

- 1) *The proposal reduces savings and investment, harming future living standards and making it harder to finance future pensions;*
- 2) *In addition, in the face of a decline in the labor force, a Notional Defined Contribution (NDC) plan has an inbuilt growing deficit, creating a downward spiral towards higher taxes, or further reductions in saving, or failing to keep pension promises;*
- 3) *Administrative costs, including set up and running costs, are significant;*
- 4) *The redistributive effects are poorly defined.*

Proposal A maintains most of the characteristics of the current pension system and is insufficient to fulfill the objective of sustainably improving the system's coverage and pension amounts. Proposal A:

*Proposal A maintains most of the characteristics of the current pension system and is insufficient to fulfill the objective of sustainably improving the system's coverage and pension amounts. Proposal A:*

- 1) *Fails to appreciably improve the pensions of current and future pensioners;*
- 2) *Does not create a new social contract that would give the pension system legitimacy;*
- 3) *Given this context, the proposal does not allow for the creation of opportunities for a social consensus to accept the parameter changes required to provide the system with long-term viability;*

4) *Continues to put most of the risks of investment on workers in the sense that they are the ones who must face the uncertainty of benefits from a contributory component that is entirely capitalized;*

5) *Does not reverse the current major gender inequalities;*

6) *Does not generate adequate incentives to increase the participation of self-employed workers in the pension system, nor does it increase the density of contributions for all workers*

7) *Does not reduce system costs by centralizing the system's administration in a way that would take advantage of economies of scale.*

For her part, the only commissioner who supported proposal C, criticized both the proposals A and B:

» *Proposal A aims to maintain the current system design at the cost of greater fiscal cost of subsidies, increases in the contribution rate and the retirement age.*

» *Proposal B is incapable of resolving the principle problems of the current system.*

More detailed versions of the three analyzed proposals, can be found in Appendix 4 of this report.





# THE COMMISSION'S SPECIFIC PROPOSALS AND RECOMENDATIONS

## ► VII. THE COMMISSION'S SPECIFIC PROPOSALS AND RECOMENDATIONS

In conjunction with its work on the global proposals, the Commission worked on the development of specific recommendations, an essential aspect of the President's mandate.

For this purpose, each of the members of the Commission made specific proposals. All these proposals were systematized and condensed in a total of 80 proposals, which were subsequently submitted for discussion by the Commission.

In order to determine what would constitute a "Commission proposal", the commissioners agreed that a proposal must be supported by at least a majority (half plus one) of the Commissioners, i.e. 13 people.

It should be noted that each Commissioner discussed and voted on the specific proposals in light of the global proposal that they supported. Of all the proposals that were analyzed, the Commission approved a total of 58 of them, making them the "specific recommendations".

The proposals are presented below, grouped according to their objectives.

Appendix 5 explains which Commissioners voted for, against or abstained with respect to each proposal.

Appendix 6 of this report also includes the arguments of the minority votes that some members of the Commission felt it important to include.

### A. Strengthening and expanding the Solidarity Pension System

#### Background

The Solidarity Pension System (SPS), which was created in 2008 along with the Basic Solidarity Pension (PBS) and the Top-Up Welfare Complement (APS), establishes minimum levels of benefits for the most vulnerable sectors of society, integrated from the contributory pillar. The PBS and APS are currently available to members of family groups in the poorest 60% of Chile's population.

The Commission has identified three principal challenges relating to the SPS: (a) the values of pensions provided under the system's two principal benefits (PBS and APS); (b) coverage; (c) the strategy used to focus access to benefits.

With respect to pension amounts, data show that the 2008 pension reform has contributed to a reduction in both poverty and indigence among older people. Had the Solidarity Pension System not been implemented, the poverty rate among people 65 and over would have risen to 9.6%. In contrast, the rate measured for this age group in the CASEN 2011 study was 7.5%. This 2.1 percentage point drop translates into a 0.7% reduction in the national poverty rate (thus, under the scenario with no reform, the poverty rate would have risen from 14.4% of the population as a whole to 15.1%). The reform also had a positive effect on extreme poverty (indigence) among seniors 65 and over, which was measured at 1.6% in 2011 instead of the 2.1% it would have been without this public policy. Although these figures demonstrate that progress has been made, the amount of the PBS on July 1, 2015 was \$89,764 CLP, approximately 40% of the Minimum Wage (IM) and barely above the urban poverty line (urban poverty line of 3.2 UF units). Meanwhile, the Maximum Pension with Solidarity Contribution currently stands at \$290,395 CLP per month.

Over recent years, coverage under the Solidarity Pension System (SPS) has seen a significant growth in numbers of beneficiaries, mainly as a result of the transition process mandated in the reform. In March 2010, the program had a little more than 800,000 beneficiaries, but by March 2015 it had expanded to over 1,300,000 benefi-

ciaries<sup>82</sup>. The latest figures show that the SPS currently covers around 57% of Chile's elderly population. Although this represents a major advance, the Commission believes that coverage could be even higher.

The third element of the SPS that the Commission believes should be enhanced and strengthened relates to the process for targeting non-contributory benefits. Since July 2010, benefits have been available only to those beneficiaries able to verify that they are living in poverty, using the Technical Targeting Instrument (ITF), which mainly uses administrative data from the SII and IPS systems, and information from AFPs, DIPRECA, and CAPREDENA. As mentioned above, the requirement for accessing benefits is to be a member of a family group that is in the poorest 60% of Chile's population. In order to determine whether an applicant is eligible under this requirement, their targeted Social Security Score (PFP) is compared with the value for the 60th percentile, through application of the ITF formula in the CASEN survey. If a person achieves a score equal to or lower than this threshold value, the targeting requirement is deemed to have been met. The per capita income for the 60th percentile currently stands at CLP 171,000. This is equivalent to a social security targeting score of 1206 points<sup>83</sup>.

The targeting process faces two problems - one related to a groups of persons who are entitled to provision under the Solidarity Pension System but do not request it (an inclusion problem) and the other regarding the extinction of SPS benefits when a person ceases to meet one of the requirements.

With regard to the inclusion problem, in 2012 the Social Security Institute identified 120,000 individuals who met the requirements for accessing the APS but who had not requested the benefit. An active communications campaign achieved an increase in requests and increased access by 64,000 people. Another problem arises when a person's Social Security File is not current. This obstructs the calculation of the PFP and the provision of benefits. The benefits provided under the Solidarity Pension System accrue on request.

With regards to the extinction of benefits problem, Article 27 of Law 20,255 stipulates that the benefits from the SPS must be terminated when any of the eligibility requirements are not met. Articles 24 and 29 of the same law specifies the responsibility of the Social Security Institute (IPS) to review the granting of SPS benefits, and to terminate them when any grounds for extinction have arisen. In compliance with this requirement, in mid-2012 the IPS began the first mass review of the targeting requirements, involving 1,037,555 beneficiaries. This review process determined that 1.5% of beneficiaries, or 16,556 persons, had ceased to meet the eligibility requirements. Some 60% of the persons who ceased to meet the targeting requirements had a Social Security Targeting Score between 1206 and 1871 points, placing them in the poorest 60%-80% of the population. The remaining 40% had income greater than CLP 265,000 per capita.

In summary, the Solidarity Pension System is facing pending challenges that mean that the system must be strengthened and expanded in terms of coverage and amounts awarded and that its methods for targeting beneficiaries and for determining when benefits should be terminated should also be improved.

### Objectives of the Proposals

The objectives of proposals that set out to strengthen and expand the Solidarity Pension System are:

- » Expand coverage of the Solidarity Pension System.
- » Increase the amount of the Basic Solidarity Pension and Maximum Pension with Solidarity Contribution.
- » Improve the targeting of benefits and the process of terminating benefits for the Solidarity Pension System.

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82 Including all beneficiaries of the Basic Old Age and Disability Solidarity Pension and Old Age and Disability Solidarity Security Contribution.

83 See Background Chapter 4 of the Final Report.

## Proposals of the Commission:

### ***Proposal 1: Expand the Solidarity Pension System to cover at least 80% of the population***

Benefits provided under the Solidarity Pillar are currently available to members of family groups in the 60% of the Chilean population with the lowest income. With this proposal, the Commission proposes that progress be made towards universal coverage of this benefit.

### ***Proposal 2: 20% increase in the amount of the Basic Solidarity Pension and the Maximum Pension with Solidarity Contribution.***

### ***Proposal 3: Change the mechanism for accessing Solidarity Pension System benefits, from the current Instrumento Técnico de Focalización (a means test) to an affluence test.***

Changing the mechanism for accessing Solidarity Pension System benefits, from the current instrument (a means test) based on the Social Protection File to an affluence test (which measures overall wealth), would require the country to implement an integrated social information system and to create an institutional framework to maintain complete records, allowing individuals' level of income, membership in family groups, health, and personal dependency relationships to be identified from administrative records. To be able to access better information about individuals, the public institutions that collect and provide the information must be modernized.

In the transition towards the development of targeting mechanisms that measure affluence, the ITF should be reviewed to minimize the use of information that relies on self-reported data. To do this, the Commission proposes that there first be a review of the use of a measurement of Income Generating Capacity, built using administrative data. A further proposal calls for an evaluation of the possibility of creating a needs index using administrative data.

### ***Proposal 4: Review current mechanisms for targeting non-contributory benefits, through more effective application and periodic verification.***

The Commission proposes that the targeting mechanism be reviewed every 3 years. This will prevent people from entering and leaving the

Solidarity Pension System as a result of fluctuations in their monthly income, while still maintaining the oversight required by law.

A second proposal suggests a series of general improvements to the technical instrument used for targeting benefits. To accurately assess potential beneficiaries, there must be progress towards the creation of accessible databases of information. These databases must be periodically updated so that they can offer users timely and current information to calculate beneficiaries' scores and to minimize the potential impacts of transitory changes in beneficiaries' income.

In order to minimize potential exclusionary errors, given that the time gap between when the income information is collected and when the PFP values are calculated, the Commission recommends exploring the feasibility of obtaining and using more recent income information, particularly for beneficiaries who are close to the threshold and for whom work income is a significant variable in potentially losing benefit eligibility.

The instrument should also incorporate elements to reduce the impact of transitory income that could affect the beneficiary's continued eligibility for benefits with the threshold determined by Law 20.255. The Commission also proposes that variables that identify incentives to strengthen the participation of seniors in the labor market as they approach retirement age be included in the review process of beneficiaries as well as in the targeting score calculations.

Finally, the Commission would like to eliminate the discretionary elements of the beneficiary review process (for example, when and how the process takes place) to prevent postponements of the review according to political cycles.

The Commission also suggests evaluating the possibility of establishing a range of scores (a threshold band) relating to the cut-off for access to the SPS, which could be applied to the reviews of the targeting requirement. This would prevent people with PFP scores close to the cut-off from entering and leaving the solidarity system.

Another area for improvement in application processes for SPS benefits relates to changing the

calculation formula for the Social Security Targeting Score so as not to deter SPS beneficiaries from remaining in the labor market. The next section provides further information on this proposal.

### Expected Results

The Commission expects that the proposals that strengthen and expand the Solidarity Pension System will guarantee a base level of social security and, therefore, of protection of citizens' rights. The coverage of the SPS system, final pensions, and replacement rates will also be increased. This increase is also expected to be more significant for women than for men, as women receive a greater proportion of SPS benefits.

Meanwhile, the proposal to transition from a means test to an affluence test will allow for a shift in who is responsible for providing information, shifting the responsibility from applicants to the State, and making it easier for people to submit applications, complete the necessary forms and provide documents. Furthermore, the State possesses information taken from administrative databases that would allow it to examine a number of components of wealth (wages, income, savings, investments, goods owned, real estate, etc.), allowing beneficiary targeting to be more precise.



## B. Strengthen the contributory pillar, expanding coverage and contribution density

### Background

The coverage of the current pension system, measured as the proportion of employed persons who pay into the system, is among the highest in Latin America, at 69.3% according to the latest CASEN study and is strongly related to the proportion of salaried or dependent workers who participate more actively in the system. Nevertheless 25% of workers are self-employed or freelance, either as employers or on their own account and only 6% of these workers chose to make voluntary pension contributions. This fact is relevant, given that on average people spend 12.6% of their time as self-employed workers.

Under Law 20,255 of 2008, independent workers are under an obligation to make social security contributions for pensions, workplace accidents, occupational illnesses, and health. The measure was phased in gradually: in 2014, the obligation was to make contributions on 40% of income and this percentage increased gradually to 100% for the 2016 tax year. Considering the number of potential users who have refused to contribute, the coming imposition of mandatory contributions will mean that a large number of workers will suddenly face an abrupt increase in required contributions into the system. This blow will be exacerbated if this requirement has not been accompanied by a campaign of welfare education that might have eased the transition. Finally, the amount deducted will not be sufficient during the first year of mandatory contributions—a problematic aspect that will be made worse in the near future when contributions for health care are also included in the requirement.

The Commission also evaluated the effect of a series of social programs on incentives for labor formalization and social security coverage. This analysis has shed light on a contradictory effect of some programs. In particular, when eligibility for a given benefit is contingent on low income, incentives for under-declaration are increased—most notably for Fonasa Group A beneficiaries or Family Allowance beneficiaries.

### Objectives of the Proposals

One objective is to bring all self-employed workers, irrespective of whether they provide professional fee receipts into the system. The goal is to innovate in the process for affiliation and for the collection of contributions by using mechanisms other than monthly deductions by employers, and, through this innovation, to increase coverage and savings for active workers.

Another objective is to reduce the disincentives to the contribution amounts and density unintentionally created by social programs such as Fonasa and the Family Allowance, and to incentivize true declarations of income.

### Proposals of the Commission:

***Proposal 5: Create an institution capable of pro-actively coordinate policies for bringing affiliates into the system and collecting contributions.***

This institution should take into account the specific features of different employment categories, safeguarding the social protection of self-employed workers and focusing on how each professional area and position obtains income and payment for services. Based on this knowledge, the institution should design specific instruments and coordinate the institutions necessary to collect social security contributions—by, for example, deducting contributions from patents granted or declaring equivalent annual incomes for seasonal activities.

This unit will also be tasked with overseeing the coordination of different social programs and incentives to pay into the social security system.

The coordination unit should be located at the Ministry of Labor and Social Security, and act in co-ordination with other public bodies such as the Ministry of Health, Ministry of Economics, Ministry of Social Development, and Internal Revenue Service.

**Proposal 6: Maintain the obligation for self-employed workers to make social security payments, as stipulated under Law 20,255 adapting its gradual implementation.**

The Commission proposes that the obligation for self-employed workers to make social security contributions, as stipulated under Law 20,255, be maintained with adjustments to its transitory regulations.

The Commission suggests evaluating an extension of the period of obligatory contributions based on 100% of an affiliate's taxable income as currently stipulated for 2016, given that a significant number of people have chosen not to pay into a pension fund, meaning that this measure would bring about an abrupt jump in their required contributions.

The new proposal for gradual application should provide effective access to workplace accident insurance for self-employed workers, and include health plan contributions.

Together with the proposed gradual phasing-in of the requirement, the Government and social security institutions must implement a welfare education campaign to encourage the implementation of these measures.

**Proposal 7: Remove a range of disincentives to contribute associated with other social programs such as FONASA, Family Allowances, and the assignment of a score for access to benefits of the Solidarity Pillar.**

The proposal is to remove the dramatic cut-offs in two benefits: health insurance (FONASA) and the Family Allowances currently based entirely on income thresholds.

The sudden drop in benefits provided under social programs when a user's income level rises leads to major distortions in the targeting of social programs and the formalization and true declaration of income. Therefore, the proposal calls for the adoption of two linear reduction systems based around users' income.

The FONASA co-pay for an individual with two or fewer dependents will be redefined as the surplus of the average income plus the average

monthly pension recorded over the previous two calendar years, as a proportion of the threshold for accessing free health services (currently standing at \$206,000 CLP) measured in thousands, multiplied by a factor of 0.15 (replicating the current 15% co-pay for persons with income equal to or less than \$306,000 CLP). The co-pay would be capped at 50% (this cap would apply for every case where an affiliate's income plus the pension would be greater than CLP 543,000 per month). For individuals with three or more dependents, the surplus of income and pension will be reduced to \$50,000 CLP per dependent.

Similarly, the amount of family allowance should be redefined as a base amount similar to the current \$9,242 CLP per dependent for incomes that are less than the basic pension, which are subject to a deduction of the surplus income that is more than the basic pension. The percentage point reduction of this benefit would be equivalent to total average income plus monthly pension recorded over the past two calendar years, over the basic non-contributory pension, multiplied by a factor of 0.2 (making the benefit drop to zero for all income equal to or greater than \$537,825 CLP).

There is also the situation wherein people who are covered as primary account holder of a good health plan reach the age of 65 and wish to apply for the Solidarity Pension System in order to obtain a PBS. Upon being awarded a PBS, the person enters the category of "pensioner" and is thus entitled to health coverage. The Commission believes that it would be useful to analyze how people with this type of SPS benefit could be permitted to choose to be covered as a dependent of a family member if their potential health coverage could be better under this situation. This has two effects: improving the situation for the potential SPS beneficiary, and providing a fiscal saving of 7%.

If the beneficiary chooses to be a dependent, they will lose their classification as primary account holder and also lose the 7% that is paid by the State.

**Proposal 8: Modify the formula for the Social Security Targeting Score (Puntaje de Focalización Previsional) so as not to deter beneficiaries from joining the formal labor market.**

Specifically, the Commission proposes that after a benefit has been awarded, a beneficiary's income should not be included in the PFP calculation formula, up to a certain limit (for example, up to an annual amount equivalent to 12 or 24 times the PMAS).

To correctly evaluate potential beneficiaries, the Commission believes that it is important to develop accessible databases with timely information that is regularly updated and that can be used to calculate beneficiaries' scores, thereby minimizing the potential impacts of transitory changes in users' income. To minimize potential errors of exclusion that may occur due to the time lag between when the income information is collected and when the PFP values are calculated, the Commission recommends an assessment of the feasibility of obtaining and using more recent income information, particularly for beneficiaries close to the threshold and for whom work income is a significant variable in potentially losing benefit eligibility.

The instrument should also incorporate elements to reduce the impact of transitory income that could affect an affiliate's continued eligibility for benefits under the threshold established by Law 20,255. The Commission also proposes that the beneficiary review processes and targeting score calculations should include variables that identify incentives developed to strengthen participation by older people in the labor market as they approach retirement age.

## Expected Results

Implementation of the foregoing measures is expected to increase contribution density for system affiliates, particularly for those with employment and work histories concentrated in less formal sectors. The effect of increased contributions would be larger pensions.

It is vital that the system include the tools necessary to incorporate self-employed workers into the system, in compliance with social security labor regulations. A Coordination Unit could have a positive impact on this issue, by monitoring and following up on the different legal and administrative initiatives that seek to incorporate self-employed workers into the social security system and by taking into account the specific working conditions of different activities and unions. This

Unit should also review the compatibility of different social programs in the pension system, coordinating with other public institutions such as the Ministry of Health, Ministry of Economics, Ministry of Social Development, and Internal Revenue Service. This initiative is expected to reduce factors that currently deter workers from contributing based on their real income, without harming current beneficiaries of these programs, and to therefore promote pension saving.

With regard to the effective implementation of mandatory contributions, it is worth highlighting the importance of how the measure is phased in with respect to its results. The way the measure is implemented will determine how long the country has to promote the compulsory contributions of self-employed workers, and it may also mean that there are insufficient resources for their final pensions.

The Commission wishes to underscore the fact that, despite the reduction in pensions with respect to full mandatory contributions on the entire income, the phasing in will also prevent self-employed workers who, until now, have chosen not to contribute from facing a dramatic change in their income, and it will have a limited effect on the youngest self-employed workers.

These measures are expected to incentivize participation in the labor market among PBS beneficiaries. This, together with policies to boost employment among older people, will allow their income levels to increase.



## C. Increase savings in the contributory pillar

### Background

In the Pension System established under Decree Law 3.500, an affiliate's pension amount depends on, among other factors, how much the worker has accumulated in their individual capitalization accounts during the course of their working lives. The pension fund contribution rate is 10%, a fairly low figure by international standards<sup>84</sup>, and in comparison with the former pension system. Similarly, employers make no contribution to pension funds, except for work classified as "heavy".

There are also allowances and bonuses that increase workers' overall income but are not classified as part of their "salary" and so are not subject to tax and social security deductions. The maximum value of non-taxable allowances that may be paid to any worker under the Labor Code is not established by law, but the Labor Department, the SII (Internal Revenue Service), and other regulatory institutions have established applicable norms that indicate that such payments must be suitable for the purposes of the allowance in question. That means that the amount of the allowance must be reasonable and prudent. In the public sector, non-taxable payments are not defined in a uniform manner for all workers, and such allowances are only paid to workers specified in the relevant legislation.

The figures show that the most strict criterion established for workers covered under the Labor Code requires that non-taxable allowances must not represent more than 10% of a worker's gross taxable income, while in the public sector the average expenditure on allowances comes to around 23% (for salaried workers) and 18% (for hourly workers) of total labor expenditure governed under the Administrative Statute.

Meanwhile, labor evasion, failure to make contributions, and under-reporting of income are severe problems that affect the performance of the pension system in terms of the system's coverage and of the adequacy of the pensions

delivered to citizens. CASEN 2013 indicates that around 5.5 % of salaried employees fail to make pension contributions even though their employers are under an obligation to verify such contributions (social security evasion), and that a further 12.5% of salaried employees fail to make payments because they lack a labor contract (labor evasion).

As established under Article 16 of the 1980 Decree Law 3.500, the taxable cap is the limit that establishes the maximum amount of income that shall be subject to pension contributions. Notwithstanding adjustment of the taxable cap, over recent years the average income in the pension system has grown over the real income index (IRR). Since the system's taxable cap is adjusted in line with changes in IRR, it is clear that the actual income of affiliates subject to the taxable cap have increased faster than the values of their obligatory social security contributions. This phenomenon has affected not only members of the highest income quintile of the population, but also middle-income individuals, as income variability means that their contributions are sometimes based on values higher than the taxable cap.

The voluntary pillar is one of the system's three fundamental pillars. Workers are free to choose from a wide range of capital market institutions and financial instruments to administer the funds accumulated from voluntary contributions and agreed-upon deposits. Nevertheless, in March 2014 the total value of the APV stood at US\$ 6.856 billion, or just 4.5% of all pension funds in mandatory accounts. The 2008 reform introduced Collective Voluntary Social Security Savings (APVC), a system whereby employers may choose to offer their workers a savings system that will both improve the workers' pensions and also act as a mechanism to encourage savings in the company. Nonetheless, a year and a half after it was introduced, the use of the APVC mechanism had failed to meet expectations, and so in April 2011 the regulations were amended to add flexibility to certain conditions required for the creation of plans. Still, coverage remains very low, with just 127 contracts signed, covering a total of 2,211 workers as of March 2014.

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<sup>84</sup> The average contribution rate reported in OECD countries is 19.6%. In the vast majority of the OECD countries, the employer is responsible for 57.1% of the contribution for old age pensions and the employee is responsible for 42.9% of the contribution.

## Objetivos de las Propuestas

This collection of proposals sets out to:

- » Increase the value of self-financed pensions through direct increases in the taxable base and the percent of contributions
- » Ensure greater sustainability to allow the system to support the increased costs of the Solidarity Pension System and to improve contributory pensions.
- » Increase the system's coverage through better control of social security evasion and avoidance, improving the processes for collecting and receiving social security contributions.
- » Increase the balance of the individual accounts, promoting voluntary pensions saving.

## Proposals of the Commission

**Proposal 9: Establish a new social security contribution payable by employers, amounting to 4%.**

**Proposal 10: Establish that at least a portion of the higher contribution of 4% paid by the employer will go to a solidarity fund.**

Together with the establishment of a new contribution of 4% payable by the employer, the Commission agreed that a part of that contribution should go to a solidarity fund. The different possible means of distributing this new contribution between the individual accounts and the solidarity fund are presented in Appendix 4.

**Proposal 11: Consider a transition period of at least four years for the proposed increase in the contribution rate, in order to reduce the negative effects on the labor market.**

An increase in the contribution rate has the potential to bring about a significant rise in pensions, so long as it actually translates into greater amounts collected. This will occur if neither wages nor employment levels are affected. But it is not obvious what the cumulative effect of the changes to the contribution rate will be, and an increase in contributions might affect both salaries as well as workers' access to formal employment, which would then limit the measures' collective impact on overall pension savings. In

this light, the proposal to increase the contribution rate must be examined in parallel with the following considerations:

- » Increases in the collection rate must be accompanied with suitable education and information campaigns to explain the effects of these changes on pensions.
- » There is evidence that increases in collection rates have effects on employment and on wages, so they must be phased in gradually, over a period of at least 4 years.

**Proposal 12: Establish a regulation that limits the portion of a worker's income that is not subject to social security deductions**

Irrespective of the different regulations relating to non-taxable allowances for workers employed by the Central Administration of the State and Municipalities and the regulations established for workers covered under the Labor Code, for the purposes of pension, no more than 5% of a worker's monthly income may be excluded from contribution deductions.

**Proposal 13: Increase and standardize the ceiling for pension contributions from the current limit (73.2 UF) to the ceiling currently in effect for unemployment insurance (109.8 UF)**

Increase the ceiling for pension contributions from the current limit (73.2 UF) to the limit currently in effect for unemployment insurance (109.8 UF). This upper limit should be readjusted in accordance with the annual variation in the INE real income index. The increase must be phased in over the course of a transition period.

Considering the impact on the liquid wages of affected workers, an evaluation should be conducted into the applicability of phasing the process in gradually.

**Proposal 14: Create a Social Security Division as part of the Labor Department reporting to Office of the Undersecretary of Social Security on all matters related to declarations, contributions, oversight, and collections regarding social security.**

This division should create a "Social Security Technology Platform" (PTSS), which would have

an electronic repository and information system. There would be a legal obligation to register all labor contracts on the platform when they are signed, regardless of their duration.

This proposal is drawn from the results of studies by the Universidad de Chile (2012)<sup>85</sup> and Ciedess (2014), commissioned by the User's Commission and the Social Security Advisory Council, "Analysis and proposal to reduce evasion, under-reporting, and judicial collection of social security contributions". The Commission endorses the proposals made in that document, which set out to increase the efficiency and effectiveness of the oversight, control and collection of social security contributions, in at least the areas specified below:

- a) Regulations, which may include legal and regulatory aspects and instructions.
- b) Institutional, administrative, and operational aspects that could be improved.
- c) Design or redesign of incentive mechanisms. At this level, the Commission proposes monetary incentives that could minimize the potential effects of financial sanctions associated with evasion and avoidance.
- d) Design or redesign of work processes and other operational aspects, including information processes.
- e) Resources necessary to execute applicable processes (human, financial, databases, and information systems).
- f) Administration and resolution of the backlog of pending court cases based on collecting contributions.

**Proposal 15: Increase the currently low fines payable by employers who withhold funds from workers' incomes and then fail to pass on workers' social security contributions.**

85 "Análisis de la Evasión y la Elusión en el Pago de las Cotizaciones Previsionales y Medidas de Política Pública para Superar sus Causas" [Analysis of Evasion and Avoidance of Social Security Payments and Public Policy Measures to Overcome the Causes], Department of Economics, Universidad de Chile, November 2012, p. 272.

Increase the currently low fines payable by employers (0.75 UF) that withhold funds and then fail to pass on workers' social security contributions. Establish a streamlined and effective procedure for court-ordered sanctions, and publish a list of debtor companies and entities.

**Proposal 16: Extend the period of compulsory contributions to the age of actual retirement from the labor market. In cases where that age is older than 60 for women and 65 for men.**

The proposal seeks to eliminate the current option that affiliates have to make no contributions during the period between when they reach the legal retirement age and when they actually decide to retire from the labor market. In cases when the person has access to a stable source of income during that time, this measure will increase the balance of that individual's pension account.

**Proposal 17: Introduce changes in APVC (Collective Voluntary Pension Saving) regulations, so as to increase the number of companies and unions that join this voluntary saving mechanism.**

## Expected Results

These measures will result in an increase in the contribution rate for individual capitalization accounts while maintaining the taxable income base constant, and will therefore increase pension savings and self-financed pensions.

Greater pension savings and larger self-financed pensions will reduce the costs associated with the Solidarity Pillar. This reduction will depend directly on how the increase in contributions is distributed between the Solidarity Fund and the individual capitalization accounts. Nonetheless, one indirect impact of the increases in labor costs associated with higher pension contributions (regardless of whether they are paid by employers or workers) will probably be the effects on rates of informal employment in the labor market.

The introduction of limits on non-taxable allowances and of increases to the cap on taxable income will lead to direct increases in the taxable base income, which will translate into increases in pension savings and self-financed pensions.

Raising the cap on taxable income will not only raise savings levels; it will also increase the base income for the upper limit on deductions, leading to a rise in the requirements for taking early retirement among this group of individuals, encouraging them to remain in the labor market longer.

Finally, the Commission expects there to be progress from the current enforcement system for evasion, avoidance, and under-reporting of income, towards a preventive model that will not only provide for more effective and efficient oversight for the collection process, but also create incentives for both employers and workers to meet their social security obligations.

Access to timely information about workers' entry into and exit out of the formal labor market would allow for electronic oversight to proactively detect and prevent eventual infractions of the relevant pension and social security laws.



## D. Increase the legal retirement age and introduce incentives to work by older persons

### Background

#### Life expectancy and legal retirement age

The legal age of retirement and life expectancy rates for men and women are relevant factors for pension amounts, as they determine how the funds accumulated by affiliates will be distributed over time.

In Chile, women have greater life expectancy rates than men do; in 2015, life expectancy for women was 81.69 years, and 76.52 years for men<sup>86</sup>. It should be noted that although women have a longer life expectancy than men, their disability-free life expectancy is shorter; this is why the retirement age for women is 5 years younger in Chile than it is for men (60 years old for women as compared to 65 years old for men). ENADE-AM showed that the dependency gap between men and women begins at age 65.

The lower retirement age for women, together with pregnancy, childcare, and care for other family members, all mean that women generally have a shorter period in which to accumulate retirement funds, despite the fact they generally live longer. This discrepancy reduces their monthly pension amounts. The effect of the lower retirement age combines with other gender-differential factors relating to participation in the workforce, wages, social division of childcare and housework, and life expectancy, and results in substantially lower pensions for women than for men.

Beginning in 2016, new mortality tables, calculated by the SVS/SP, be used. Preliminary findings indicate that life expectancy of pensioners aged 65 will increase by 0.94 years for men and 1.52 years for women, compared to life expectancies in the current tables. This increase will result in a reduction in new monthly pension amounts by 2.7% for men and 3.8% for women, assuming married individuals in both cases, with a scheduled withdrawal interest rate of 3%.

In light of Chile's demographic transition, the requirement that women reach 60 and men reach 65 in order to access their contributory pensions is clearly out of date. This is not a problem unique to Chile. Many countries around the world are experiencing similar changes. Their responses to these changes have included short term or long term increases in the retirement age (e.g. Canada or New Zealand). It should also be mentioned that retirement ages are the same for men and women in most countries.

#### Labor participation and income among older people

This increase in life expectancy among the population gives rise to a need to reassess the length of men and women's active working lives as well as to examine the conditions of their employment during the later stages of this period. Information gathered for this study shows that many workers face difficulties in the labor market during the years leading up to the retirement age and afterwards if they decide to remain in the labor market. The solutions to these problems of precarious employment conditions must be found in the labor market rather than in the pension system.

According to information from the CASEN Survey, after men reach 60, there is a drop in their participation rate in the labor market, dropping in 2013 from 78% (for those aged 60 to 64 years old) to 29% among those aged 65 and over. The same trend in labor participation is seen among women, for whom the 2013 employment rate stood at 49% for those aged 55 to 59, dropping to 34.6% for the 60-64 age group and 9.5% among those aged over 65.

A policy focused on extending the working life of older people requires consideration of the quality of employment available for those seniors who continue to work. One way of measuring this is by looking at the income recorded for people over 60 years old, which is generally lower than the income for the rest of the population, mainly as a result of their gradual retirement from the labor

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86 INE. Chile Population Projections 2020-2050, commissioned by the Presidential Advisory Commission on the Pensions System.

market<sup>87</sup>. In Chile, if one only looks at autonomous income, income of those over 65 is equivalent to 67% of the income of the rest of the population. When subsidies (monetary income) are included, this proportion rises to 70%. For reference, this indicator averages 86.2% among OECD countries<sup>88</sup>.

Meanwhile, the estimation of Real Retirement Age (average retirement age over a 1 to 5 year period, weighted by the proportion of retirements from the workforce) from the CASEN database shows that the aggregate average retirement age in 2013 was 67.5 years, which has increased 3.2 years since 1990. As would be expected, a gap is observed between men and women for all years, with an average retirement age of 69 years old for men and 64.8 years old for women.

In view of this background information, it is suggested that there is a need for adjustments in the legal retirement age in line with increases in life expectancy among the population. At the same time, policies and strategies are needed to support older people who remain in the labor market.

### Objectives of the Proposals

- » Increase the period during which affiliates accumulate funds in the contributory pillar, adjusting it to be in line with demographic changes and the aging of the Chilean population.
- » Prolong and improve the active working years of older persons through incentives and postponement of the retirement age.

87 Autonomous income includes wages and salaries, income from independent work, self-provision of goods produced in the home, bonuses, gratifications, revenue, interest, pensions, mutual benefit income and transfers between private parties. Meanwhile, monetary income comprises autonomous income plus financial subsidies (cash contributions from the State to persons and homes through social programs); autonomous income and monetary income generated as of the CASEN study will be used. Source: Ministry of Social Development. Social Observation Group.

88 OECD 2013

### Proposals of the Commission

#### ***Proposal 18: Match the retirement age of men and women.***

We propose to phase the change in gradually over 10 years, to eventually bring the retirement age of women up to match the age of men. This change would begin with generations born since 1970, in accordance with the following table:

Women born in	Retirement Age
1969 or earlier	60 years old
1970	60 and 6 months
1971	61 years old
1972	61 and 6 months
1973	62 years old
1974	62 and 6 months
1975	63 years old
1976	63 and 6 months
1977	64 years old
1978	64 and 6 months
1979	65 years old

#### ***Proposal 19: Periodically review the retirement age.***

Following completion of the transition to standardize the retirement ages of men and women, the Commission proposes a periodic review of that retirement age. This review could be the task of an Actuarial Council that would conduct its analysis in light of aspects such as healthy life expectancies for different educational levels and work possibilities for older persons with different types of experience and education. These ages could also be indexed to a healthy life expectancy.

#### ***Proposal 20: Incorporate an incentive for those beneficiaries of the Solidarity Pension System who postpone their retirement.***

Amend Law 20.255 to create an incentive for workers to wait to request benefits from the Solidarity Pension System until after they have turned 65. In this way, those who have the right to receive a pension may postpone it and receive a

proportional increase in benefits under the Solidarity Pillar.

A table must be designed to provide a greater sum under both the PBS and APS systems for each year that retirement is postponed. In parallel, consideration could be given to allowing a proportion of the benefit not requested for each year to be offered to the pensioner in cash upon retirement after 65.

This benefit would require individuals to postpone their real retirement age, with regards to both Decree Law 3.500 and the Solidarity Pension System.

***Proposal 21: Establish a subsidy to encourage the employment of older people similar to the current Youth Employment Subsidy.***

Establish a subsidy for employment of older people under terms equivalent to the current Youth Employment Subsidy (Law 20,338).

This subsidy must be applicable to men and women who comply with the following requirements:

- » Aged 60 years old or older
- » Have a Social Protection File score that places them in the 60% of the population with the lowest income

This subsidy will be for a value of up to 30% of the employee's taxable income, with 20% distributed directly to the worker and 10% to the company, with implementation similar to that stipulated under Law 20.338, operated by SENCE (National Training and Employment Service).

***Proposal 22: Establish high quality jobs for senior citizens as an objective of labor policy and develop specific programs for this age group.***

Establish that the creation of high quality jobs for seniors is an objective of labor policy. For these purposes, the Commission proposes that the Ministry of Labor and Social Security should explicitly incorporate this target group into their policies and should develop specialized instruments that include:

- » Suitable job training programs for this age group

- » Programs of labor intermediaries, including support for job seeking seniors.
- » Work skill certification programs for this group, taking into account their work experience.
- » Assessment of current labor legislation, in terms of its suitability for providing older persons with part-time working opportunities.

## Expected Results

The changes proposed seek to increase the funds accumulated by affiliates, particularly for women, who currently accumulate funds for a shorter period than men. At the same time, these measures should be implemented in conjunction with strategies that set out to increase the labor participation of older persons and the quality of work opportunities, and to eliminate the disincentives to work in the solidarity pillar.

Matching the retirement ages of men and women will also help to end the gender disparities in the parameters of the current system, allowing men and women to have the right to remain in the labor market for the same amount of time, and with the same retirement conditions.

## E. Reduce the risk to which affiliates are exposed

### Background

Funds accumulated in AFP accounts are exposed to a high level of risk, which may cause major losses such as the one that occurred during the 2008 crisis, which are mainly assumed by affiliates.

The average annual gross real return on investment (without discounting fees) for pension funds between 1981 and 2013 was 8.6%. Nonetheless, the returns that individuals actually received, while significant, were far lower than has traditionally been reported as the gross return of these funds. Given the global context of low interest rates for debt instruments, which may continue in the medium term, Pension Funds will also struggle to achieve returns on investment at the same rates that they have achieved in the past. Lower returns will directly affect the accumulation of pension funds, and will this translate into smaller pensions.

Although a sector of the population values being able to make active decisions regarding their savings, the Commission is concerned that many affiliates who choose funds of this type are unaware of the risk that underlies their decision. Historical data shows that the performance of those who have made an active choice to change funds has been lower than the default strategies. For example, 82% of all affiliates who transferred to different funds between 2008 and May 2013 received lower returns on investment than affiliates who remained in the default assignment strategy at the time, and 72% received lower returns than they would have had they followed the passive strategy.

In terms of investments, the Superintendence of Pensions is the entity responsible for preparing and updating the Investment Framework. The law states that the Investment Framework is established by a resolution passed by the Superintendence of Pensions, following receipt of a report by the Technical Council on Investments. Meanwhile, as stipulated under Article 167 of Decree Law 3.500 of 1980, the general function of the Technical Council on Investments is to prepare reports, proposals, and pronouncements regarding investments made and held by Pension

Funds, in order to ensure that the funds achieve suitable returns and have sufficient security. As stipulated under Article 167 of Decree Law 3.500 of 1980, the functions and roles of the Technical Council on Investments include "commissioning technical studies relating to the investments of Pension Funds". Thus far, the Council has not made use of said power, perhaps because under Article 169 of said Decree Law, the Superintendence of Pensions is the entity responsible for providing it with the resources necessary for completion of its functions.

### Objectives of the Proposal

- » Increase pension amounts by reducing the maximum level of risk to which workers' pension savings are exposed. By reducing risk exposure, the system will also bolster long-term financial sustainability, reducing possibilities of losing savings held for pensions.
- » In the specific case of workers approaching retirement age, the goal is to achieve greater stability in the value of pension savings by restricting affiliate's ability to select higher risk funds.
- » Ensure higher future rates of return by expanding the spectrum of investments authorized for Pension Funds, and developing new financial instruments focused on domestic production investment to benefit small and medium-sized companies.

### Proposals of the Commission

**Proposal 23: Delegate relevant decisions regarding the investment regime of the Technical Council on Investments, which will require expanding its powers.**

The proposal is to grant the Technical Council on Investments a greater degree of independence in the management of its budget, so as to better fulfil its mandate to carry out technical studies relating to the investments of Pension Funds. The ability to commission independent studies will also be strengthened if it established that the Council would have a permanent technical team dedicated to carrying out the Council's work.

**Proposal 24: Allow a greater proportion of investment to be made in real assets (alternative assets and investment funds) and find new ways to limit difficulties caused by the absence of continuous market valuation of these assets.**

The risk-adjusted returns of pension funds could improve considerably if fund administrators were permitted to invest in alternative assets.

These assets have generated greater returns for public markets, because they exploit the broad mandates given to the AFPs and they are opportunistic and generally less liquid. These types of assets would generate a potential risk-adjusted return that is attractive yet there is little correlation between those assets and the markets where the AFPs are investing funds today.

There is ample evidence and international experience on the desirability of including such assets in funds with similar mandates to that of the AFPs. (Pension funds and endowments from foreign universities have invested percentages that are several times higher than the current investment of pension funds in this type of asset, which is restricted by regulation.) This may require changing the investment regulatory framework in order to allow direct investment of funds in this type of asset.

**Proposal 25: Develop new instruments to invest in national production, specifically ones that can benefit small and medium-sized businesses.**

Despite the development of Chile's stock market, there is a lack of sufficient domestic traded securities to absorb the investment of a fund that amounts to 61% of GDP (in the past, demand for domestic stocks led to overvaluation). There is, therefore, a need to develop new domestic production investment instruments, specifically ones that can benefit small and medium-sized businesses.

**Proposal 26: In the context of the current five multifunds, restrict access to Fund A.**

This measure limits the risk of crisis for affiliates whose advanced age means that they would not have time to recoup their losses, given that in the event of a crisis sometime during the next 20 years an investment strategy that does not in-

clude Fund A will outperform a strategy based on Fund A for a person that is 20 years or less away from retirement, in terms of expected the replacement rate and standard deviation associated with said replacement rate.

**Proposal 27: In the context of the current five multifunds, reduce the maximum risk exposure of workers' pensions savings, beginning when they are 20 years from the retirement age.**



Starting 20 years before they reach the legal retirement age, workers should be required to transfer investments that they hold in Fund A to other funds. This compulsory transfer currently takes place just 10 years before legal retirement age.

Ten years before they reach legal retirement age, workers should be required to transfer their savings to a structure that also does not include Fund B, and with a maximum of 50% of savings invested in Fund C. Currently, older workers can

keep any proportion of their savings in Fund B up until the time of their retirement.

Workers within 20 years of reaching legal retirement age and who do not specify their fund selection shall be assigned to Fund D. Currently, only workers within 10 years of reaching retirement age are assigned to this fund.

Under this proposal, the default mixed fund allocation strategy would be based on the following system:

**Table 17. Proposal of default fund assignments by age brackets (for affiliates that do not make an active choice)**

Men	Up to 35	35 to 45	45 to 55	Over 55	Retirement
Women	Up to 30	30 to 40	40 to 50	Over 50	Retirement
<b>A</b>			X	X	X
<b>B</b>	Default		50% of the fund	X	X
<b>C</b>		Default			
<b>D</b>			Default	Default	Default
<b>E</b>					

**Proposal 28: Decrease the number of multifunds from 5 to 3 (eliminating Funds A and E).**

This proposal takes into account the fact that under the current mixed fund system, affiliates are faced with complex decisions, in a context in which the public has low levels of financial literacy and of welfare education. Offering affiliates a choice of five funds in this context seems to present them with unnecessarily complex choices. A reduction to three funds would require a redefinition of the risk-return compositions and default breakdowns of the funds.

### Expected Results

The expected results of these measures are:

Increased accumulated savings at retirement for the majority of affiliates who change funds on a regular basis.

Reduced number of potential situations of critical pension equity loss in the event of a stock ex-

change crisis, particularly for workers approaching retirement age.

The development of new domestic investment instruments, which will not only bring a greater return on investment, but also will benefit small and medium-sized businesses, promoting the country's production development.

More explicit approval of investment in real assets would permit greater transparency in terms of investment costs and risk exposure. Pension Funds could access a wider range of funds, thus expanding diversification options.

## F. Increase competition in the AFP market

### Background

Historically, assets in the system (funds managed plus the sums required on hand) have been held by a limited group of stakeholders. The motivation for introducing a bidding process for the portfolio of new affiliates was to increase price competition, but only a small proportion of affiliates have switched to the AFPs that won the bidding process that was introduced under the 2008 reform, so a large proportion continue to pay much higher fees.

The current bidding mechanism assigns workers starting their careers to the AFP that wins the bidding process. This group was selected for the bidding process. Existing affiliates were not included because younger affiliates have a low accumulated balance in their individual accounts so other relevant variables in choosing an AFP, such as fund return on investment, have less impact. AFPs that are already operational or that have large portfolios of existing affiliates have less incentive to offer low fees with the current bidding mechanism because they can obtain returns by staying out of the bidding process altogether, depending on the size of their existing portfolios.

In addition to normal fees, Article 45 part 2 of Decree Law 3.500 establishes the idea of brokerage fees in reference to the fees associated with overseas investments or investment in domestic mutual funds of funds managed by the AFPs with financial brokers. In 2013, the funds invested in these financial instruments represented 40% of total funds.

In terms of affiliates' preferences, although there is evidence of a low degree of sensitivity to the fees charged by AFPs, the Opinion Survey carried out by the Commission indicated that 79% of those who stated an opinion agree with the creation of a state AFP and 69% would change to one if it existed.

### Objectives of the Proposal

- » Allow new stakeholders to enter the market, increasing competition in individual savings fund management and thus reducing fees, with the expectation of increasing individual return on investment for affiliates.
- » By allowing new players in the market, diversity of administrators would also increase, allowing affiliates to choose in accordance with their own preferences.

### Proposals of the Commission

**Proposal 29: Extend the current bidding process that covers all new affiliates to include some existing affiliates, using a mechanism to be defined.**

Incentives to participate in the bidding process increase as the proportion of existing affiliates in the bidding process grows and the size of the portfolios in possession of the AFPs shrinks. If existing affiliates are also included in the bidding process, the AFPs that have not participated in the bidding process will see their share of affiliates shrink in relation to the total number of affiliates up for grabs. Therefore, the number of AFPs that take part in the bidding process will increase. This should facilitate regular changes with regards to which AFP becomes "the cheapest AFP", making the process more competitive and encouraging a drop in the average fees charged to affiliates.

Specific mechanisms should be defined, along with a prudent determination of the proportion of existing affiliates to be included in the bidding process. The Commission believes that the default should be to include a portion of existing affiliates (who would still be free to choose subsequent affiliation) in the bidding process, and thereby provide a significant increase in competitiveness of the system.

**Proposal 30: Require AFPs, rather than affiliates, to absorb brokerage fees.**

Brokerage fees should be classified as AFP administration expenses. We propose that brokerage fees for investments should be absorbed entirely by the AFPs and not by affiliates, reducing total overall fees, and rendering the fees currently charged more transparent, improving affiliates' overall pensions.

**Proposal 31: Create a state AFP which will compete on an even playing field with the other AFPs, in conformity with the legislative proposal before Congress.**

This proposal focuses on enhancing affiliation among self-employed workers and in low-income sectors. The state AFP could charge fees closer to those of low income AFPs, expanding the group of people paying low fees.

We propose that the Board of a State AFP should include at least one representative of workers, and should have a quota for a minimum num-

ber of women members (four out of nine). Board members should be approved by the Public Senior Management council.

**Proposal 32: Allow non-profit entities whose sole purpose is to manage pension funds to enter the pension fund industry.**

New AFPs entering the industry under this system would have to comply with the same regulations and standards that are demanded of other AFPs, as stipulated under Decree Law 3.500.

### Expected Results

The State AFP and bidding process proposed will translate into increased competition in the AFP market, and in a drop in the average fees charged in the system. Additionally, a State AFP would be expected to have an effect in terms of increased affiliation of self-employed workers and other low-income groups.



## G. Reduce the gender gap

### Background

In general terms, women face an unfavorable situation in the pension system: they receive lower average pensions than men and thus face a more precarious economic situation in their old age. Some of the factors that explain these differences are found within the system (both in its design and in how it operates). Other factors stem from external causes, such as, for example, gender inequalities in labor market conditions, the gender divide in unpaid work (caregiving), and changes in household composition, affecting women's capacity to work and contribute into the system.

### Mortality tables

In terms of the internal rules for the gender-differentiated calculation of mortality tables, the underlying assumptions are that with equality of wages, age, and family group of the beneficiary, the pensions offered to women should be lower than the pensions offered to men, due to differences in each gender's life expectancy. These mortality tables follow the logic of longer life expectancy for women than for men, which translate to a greater risk of longevity for women.

Mortality tables differentiated by sex were instituted starting with the 1980 reform; they were not used in the prior pay as you go system. Thus, "the mortality tables currently in use (RV-2004) calculate the life expectancy of 60-year-old women at 3.06, which translates to a survival period of 27.88 years after retirement. The same figure for men are at 0.51 years, translating to a survival period of 17.66 years after retirement"<sup>89</sup>. In 2016, new mortality tables calculated by SVS/SP will come into use. Preliminary findings indicate that life expectancy of pensioners aged 65 will increase by 0.94 years for men and 1.52 years for women, compared to current tables. This increase will result in a reduction in new pensions by 2.7% for men and 3.8% for women, assuming married individuals in both cases, with a programmed withdrawal interest rate of 3%.

Currently, European OECD countries use single actuarial curves for men and women, but in Chile separate curves are used for men and women; together with lower levels of accumulated funds by women, this means that their pensions are lower than men's pensions.

### The gender divides in paid and unpaid work, and inequality in the labor market

There are clear gender differences in the frequency or number of contributions into the pension system (density) and in the amount of those contributions. The first reason for these differences in the period during which funds are accumulated relates to inequalities and differences labor market participation. Women have lower average labor participation than men do, they earn less for the same class of work, they are less represented in more powerful positions, and they tend to have shorter and more intermittent career paths or higher levels of informal work.

Traditional gender roles associated with men and women—whereby women are more engaged in domestic tasks and caregiving responsibilities, while men are seen as the primary bread-winners for their homes—are key factors in explaining these differences. Evidence shows that married women and unmarried women with partners have lower participation in the labor market than their single or separated peers. A similar trend may be observed in differences in pension amounts; greater gender divides are detected among married people, followed by those who are divorced and separated (see Graph 44 in Chapter 5 "Gender gaps and pensions in Chile"). Indeed, data compiled by the Commission based on the 2007 Time Use Survey (EUT) show greater participation by women in unpaid activities (caregiving and domestic tasks). For women, moreover, unpaid work takes first place among activities during a typical day, after time spent resting, while this position is taken by paid work for men.

<sup>89</sup> See Background Chapter 5 of the Final Report.

## Caregivers of older people with dependencies

In this regard, care for persons with any type of dependency tends to be provided by women.<sup>90</sup> The National Dependency Survey indicates that out of all older persons with moderate or severe dependencies, 32% have a principal caregiver who is a family member, of whom 86.4% are women. 92% are not paid for caregiving tasks and the average time spent on caregiving is 8 years, with a median time of 4 years. On average, the primary caregiver for an older person with moderate or severe dependency spends 15 hours per day on care, with 50% spending at least 18 hours per day. These people receive no protection under the social security system; 48% of these caregivers are not affiliated with any pension system, while 23% are affiliated but do not make payments, and 27% pay into the system.

Failure to recognize unpaid activities carried out by women, which are of vital importance for the development of our society, together with gender inequalities and discrimination in the job market, are problems that are reflected in the current social security system, and women are forced to cover the costs of these problems on an individual level. Gender differences in labor participation and in the distribution of unpaid work have direct consequences on women's ability to make contributions into the current pension system. In this scenario, gender differences in funds accumulated over time lead to vastly unequal pension amounts. They also lead to different sources of pension financing: if the funds they have been able to save are insufficient, women will make up an ever larger share of the people who rely on the non-contributory pillar to supplement their pensions. The grant per child introduced in 2008 partially covers differences between men and women, but gaps persist.

<sup>90</sup> According to the National Study on Dependence amongst Older Persons (2010), the following classes of dependence are defined: (i) Severe dependence: individuals who need care from another person at all times, who suffer from any degree of dementia or disability affecting at least one basic daily life activity (BDLA) (ii) Moderate dependence: when an individual requires help from another person at times or to engage in at least two basic daily life activities such as washing, dressing, eating, going to bed, etc., and help for 3 instrumental daily life activities such as cooking, shopping, handling their own money, household chores, etc.

## Objectives of the proposals

The social security system must advance towards greater gender equality for pensions, and must offer equal rights and obligations for men and women, strengthening measures that establish compensatory funds to correct these problematic factors. Therefore, the Commission proposes measures designed to recognize the gender gaps and differences observed in the labor market and in the home, valuing unpaid work performed by women within the home.

The goal is include mechanisms that improve gender equality in the individual capitalization accounts, allowing costs associated with unpaid work to be shared as part of an individual capitalization pension system. It is therefore suggested that social security compensation be provided for those who are engaged in caregiving for dependent older persons. The Commission also underscores the importance of increasing child-care facilities, with the goal of helping women to join the workforce.

## Proposals of the Commission

### ***Proposal 33: Eliminate usage of sex-differentiated mortality tables.***

Elimination of the use of sex-differentiated mortality tables is proposed. The Commission suggests that they be replaced with unisex tables, with uniform calculation of predicted longevity.

This proposal is complementary to the elimination of programmed withdrawal (proposal 49) and the matching of legal retirement ages (proposal 18).

### ***Proposal 34: Establish that in the case of divorce, the division of pension funds, if considered by a judge, should be in equal parts.***

The Commission proposes that when a marriage is annulled or ends in divorce, then if the judge considers the pension fund to be divisible properly of the union (the part of the accumulated savings that came from mandatory contributions), this distribution must be equal.

### ***Proposal 35: Establish shared pension funds. We propose that 50% of the mandatory pension contribution be deposited in the individual ac-***

***count of the spouse or partner in a relationship of a cohabitation.***

The Commission proposes that 50% of a worker's mandatory contributions that would normally go into their individual pension account go instead to the individual capitalization account of their spouse or partner in a relationship of cohabitation or in a civil union (in accordance with Law 20.830).

For these purposes, the Civil Registry must inform social security institutions of marriages, cohabitation relationships, and civil unions. The obligation to share pension funds shall expire with a divorce or the termination of the corresponding relationship.

As the regulation affects new contributions into the system made once the law comes into effect; prior contributions may be subject to division in the event of termination of the conjugal relationship by a judge.

Suitable implementation of this regulation will require that cohabitating relationships must be formalized (through a civil union agreement), and there will need to be a welfare education campaign to alert the public of its importance.

This division of pension savings will not include contributions made towards disability and survivors' insurance.

***Proposal 36: Establish a social security compensation for caregivers.***

Include social security compensation for unpaid caregivers of older people and people in a condition of dependence, who work within the home, so long as this situation is certified, for example, as a member of the Program for Home Care of Older Persons. This compensation would be similar in structure to the Grant per child, and would take the form of a monthly pension contribution based on the minimum wage for each month of certified caregiving.

The beneficiary of the credit for principal caregivers of persons with severe and moderate dependence must be a family member of the dependent person.

***Proposal 37: Increase the coverage of quality early education, helping women to enter the workforce.*****Expected Results**

These proposals are designed to improve pension contributions for women in the social security system and reduce existing gender gaps. The proposals of the Commission are designed to recognize the unpaid caregiving work currently performed mainly by women, protecting them and safeguarding their rights. Compensatory measures and transfers between the sexes are designed to reduce the effect of the inequalities that affect women while they are active in the labor market, in terms of both lower participation and job quality, and to improve women's' pension funds during the accumulation phase. They also set out to improve social security coverage of women engaged in caring for older people.

## H. Expand and integrate public policies for older people

### Background

Since the 1990s, Chile has implemented public policies and actions that set out to improve quality of life for this expanding age group. These initiatives have proved insufficient. One major milestone in this area came with the creation of a special health policy for older people in 1998. The National Service for Older People was created in 2002 to coordinate public policies for the elderly, to increase awareness of issues related to seniors, and to create more specific programs, and contribute to a more permanent institutional framework.

Although the development of these institutions and policies for older people represent real progress, in the context of international agreements to promote the rights of the elderly and international initiatives that seek to expand those rights and integrate the elderly, Chile's level of development is still delayed. Some of the most significant relevant international agreements include the Universal Declaration of Human Rights (1948), the San Salvador Protocol (1988), the Brasilia Declaration (2007), and the San José Charter (2012). These initiatives have allowed older people to cement their position as holders of rights, defending their dignity and autonomy before society.

The Brasilia Declaration, which was established in Latin America in 2007, is a major milestone for older people. It expresses a firm determination to adopt local, national, sub-regional, and regional measures in three priority areas: older persons and development; promotion of health and well-being into old age, and the creation of enabling and supportive environments. A further regulation exists that directly addresses older people: the Additional Protocol to the American Convention on Human Rights in the Area of Economic, Social and Cultural Rights ("Protocol of San Salvador", 1988), which states that "Everyone has the right to special protection in old age. With this in view the States Parties agree to progressively take the necessary steps to make this right a reality and, particularly, to:

- » Provide suitable facilities, as well as food and specialized medical care, for elderly individu-

als who lack them and are unable to provide them for themselves;

- » Undertake work programs specifically designed to give the elderly the opportunity to engage in a productive activity suited to their abilities and consistent with their vocations or desires;
- » Foster the establishment of social organizations aimed at improving the quality of life for the elderly."

At a regional level, in 2007, the Brasilia Declaration was promulgated in Latin America in an effort to respond to the opportunities and challenges of aging populations and to fulfil the state's responsibility to promote and provide basic health and social services and to facilitate access to them. The San José Charter (2012) ratifies the decision espoused in the Brasilia Declaration to remain committed to promoting and protecting the human rights and fundamental freedoms of all older persons, to work towards the eradication of all forms of discrimination and violence, and to create protection networks for older people so that they can exercise their rights. Chile has yet to ratify either the Protocol of San Salvador or the San José Charter.

In an assessment of its social policies, services, and programs available for the elderly population in 36 areas that are fundamental for the well-being of seniors—health, transportation, housing, pensions, and monetary subsidies—Chile's system showed varying degrees of coverage and expenditure. There were differences in expenditure associated with different programs due to their nature and to the budget assigned to the Ministry responsible for the programs. In terms of coverage, the strongest areas are pensions and monetary subsidy programs, where leading benefits include Christmas and Independence Day bonuses, with almost two million beneficiaries, and health programs, particularly the GES health program that benefits over two million older people, and the Complementary Nutrition Program, with coverage extending to 81% of its potential population. In contrast, areas with weaker coverage include tourism and education, where no programs cover more than 35,000 beneficiaries

– equivalent to coverage of 8.3% (in the case of the Social Tourism Program). In terms of targeting, 34 out of the 36 programs reviewed target older people (with the remainder targeting establishments and professionals tasked with their care). 16 of the 34 programs are universal among older people, while 18 have eligibility requirements - the most common being validation with the Social Protection File.

Based on this background information, the Commission has reached the conclusion that there is a need to expand and integrate policies for older people.

### Objectives of the Proposal

The objectives and proposals chosen by the Commission for expanding and integrating public policies for older people are:

- » Improve quality of life for older people by coordinating policies designed to meet their needs, including monetary benefits from the pension system and benefits in kind from other policies linked to living costs, healthcare, and employment.
- » Prevent the mental and physical deterioration of older people and institutionalization of their care (long stay establishments) for mildly dependent people and/or those people who have a mild to moderate disability.
- » Temporarily strengthen and expand the autonomy and functionality of older people in daily life, in a setting close to their homes.
- » Encourage the social integration and participation of older people to expand interactions in their surroundings and promote the normalization of their situation.

### Proposals of the Commission

#### ***Proposal 38: Create a Comprehensive Protection System for Older People.***

Create an Integrated Protection System for Older People, as part of the current cross-sector social protection system established under Law 20.379, of 2009, centralized in the Ministry of Social Development.

#### ***Proposal 39: Create and implement a dependency law.***

Given that dependency—the loss of autonomy—is a situation that defines a state of maximum vulnerability, and that it can be a progressive issue for older people, special legislation (a Dependency Law) is needed, to regulate, define, and grade the severity of dependency. Within this framework, regulation may apply to care, caregivers and day centers. This law could also provide protection for caregivers in the home and in the community, as do similar laws in France, the United Kingdom, and Canada.

#### ***Proposal 40: Promote the creation of day centres.***

Incentivize the creation of day centres for older people and people with certain degrees of dependency and with disabilities.

### Expected Results

The Commission hopes that these initiatives could serve to increase quality of life for older people, especially for those who live with a certain level of dependency. It also expects these measures to strengthen public policies that target older people.

## I. Improve social security institutions, promote social participation and welfare education

### Background

With entry into force of Law 20,255, the 2008 social security reform promoted the modernization and strengthening the pension system's institutions, in their various roles. These include the Users' Commission, the Consultation Council on Social Security, the Social Security Institute, and the Superintendence of Pensions.

Two institutions were formed in 2008: the Users' Commission (CU) and the Consultation Council on Social Security (CCP). The role of the CCP is to provide direct advisory services for the Ministry of Labor and the Treasury regarding matters relating to the social security system, with a highly technical role. Members are appointed with presidential oversight for both the chair and the other full members, and the latter are also subject to confirmation by the Senate of the Republic. The Pension System's Users' Commission (CU) has a different role: it reports to the Undersecretary of Social Security regarding the general functioning of the pension system from the perspective of users and/or citizens. It represents the different stakeholders that interact in the system, that is, representatives of retirees, representatives of AFPs, of the academic world, unions, and the public system. In this capacity, members interact with the Ministry of Labor, the Undersecretary of Social Security, and the Ministry of the Treasury.

Although both of these institutions have made progress in including citizen participation in the pension system, the Commission believes that greater citizen participation is still needed and that further progress could be made towards increased citizen participation and towards a more active social dialogue between workers, employers, and the government.

Another relevant social security institution is the Social Security Institute (IPS), which is a decentralized public service that is a legal entity with its own resources and falls under the oversight of the President of the Republic through the Ministry of Labor and Social Security, through the Undersecretary of Social Security. As the legal successor of the Institute of Social Security Normalization, this public service was created under Article 53 of Law 20.255 of Reform of the Social Security

System. Its specific objective is to manage social security and social benefits and to offer access to a multi-service network for citizens, guaranteeing them access to a range of State services. It has the following functions and roles: a) managing the Solidarity Pension System, granting, suspending, and modifying benefits; b) administering the Grant per Child; c) managing the social security subsidy for young workers; d) administering and delivering family allowances for self-employed workers, in accordance with Decree Law 3.500 of 1980; e) conducting research and actuarial studies; f) managing social security frameworks for social security funds and the Social Security Service, as well as the benefits granted by that Institute, except as stipulated in Law 16.744; g) forming agreements with public or private legal entities, including for-profit and non-profit entities, that administer social security provisions; h) publishing relevant information in the field; i) forming agreements with public and private bodies for support services in the publication of information on the benefits of the Solidarity System.

The Commission considers that progress could be made in further strengthening the IPS so that it could better perform its functions and expand its range of action into new areas (such as social security advisory services and welfare education).

The Superintendence of Pensions (SP) is a major part of the institutional framework of the social security system. It is a decentralized public service with a legal identity and its own resources which relates to the President of the Republic through the Ministry of Labor and Social Security, via the Undersecretary of Social Security. Its principal role is oversight and control over the Solidarity Pension System as managed by the Social Security Institute, the private Pension Funds Administrators (AFP), and the Unemployment Funds Administration (AFC), which collects contributions, invests the proceeds, and pays out unemployment insurance benefits. Meanwhile, Insurance Companies are supervised by the Superintendence of Securities and Insurance.

In light of the importance of the regulatory role of the Superintendence of Pensions, the Commission believes that this role should be stronger and independent of the government administra-

tion of the moment. It also believes that there is a need to bring about greater synergy between pensions and insurance.

The strengthening of the institutional framework of social security must go hand in hand with increased knowledge among the public regarding the pension system, so that citizens can actively participate in the system and grant it greater legitimacy.

The investigations conducted by the Commission indicate that the public is largely unaware of how the pension system works. According to the Commission's Opinion Survey, people have the least understanding of the fees charged by AFPs and the portion of their income that subject to monthly deductions for the Pension System. According to data from the EPS (2009), people are also largely unaware of how pensions are calculated or what their contribution rate is. This lack of awareness is exacerbated by a lack of opportunities for welfare education. One of the few initiatives implemented is the Welfare Education Fund (FEP). According to an evaluation conducted by DIPRES (2012), this fund is facing major challenges: it must make progress in areas such as developing a strategic outlook, and preparing suitable instruments and indicators to monitor the functioning of the Program.

In light of this assessment, the Commission considers it necessary to promote initiatives to increase and improve the public's knowledge and understanding of the pension system.

## Objectives of the Proposal

The proposals that seek to strengthen social security institutions and to promote social participation and welfare education, have the following objectives:

- » Strengthen different existing institutions in the social security system that promote citizen participation and welfare education
- » Strengthen the institutions that regulate the pension system
- » Strengthen participation in the pension system in all the regions of the country.

## Proposals of the Commission

### ***Proposal 41: Strengthen and broaden the scope of the powers of the Advisory Council on Social Security (Consejo Consultivo Previsional).***

Expand the scope of the mandate of the Advisory Council on Social Security to include not only the Solidarity Pensions System but also the entirety of the integrated pension system.

In particular, this institution's tasks should be expanded to include:

- » Commissioning, overseeing, and disseminating actuarial studies into the pension system and its solidarity component (including the Pension Reserve Fund), every three years;
- » Requesting and conducting pension projection and replacement rate studies;
- » Evaluating the suitability of contribution rates in the system at any given time based on actuarial studies and projections, and proposing relevant modifications;
- » Using actuarial studies and projections to evaluate trends in the population's life expectancy and the appropriateness of the current retirement ages,;
- » Given the level of development required to model the pension system, it is proposed that the Social Security Consultation Council should be empowered to request that the Executive Branch provide reports from entities that have already prepared models to estimate replacement rates, as well as other relevant parameters, and other actuarial studies.
- » The Council's ability to produce independent studies would also be strengthened if the Council had a permanent technical team to support its work.

The Consultation Council on Social Security must have access to the resources necessary to address the new tasks proposed above, and must be empowered to request databases and information from permanent public institutions.

**Proposal 42: Review the constitution, powers, functions, sustainability, and integration of the current Users' Commission.**

Review the constitution, powers, functions, sustainability, and composition of the current Users' Commission, created under Article 43 of Law 20.255. The Commission proposes that the constitution of Users' Commissions in each region should be evaluated. The following items are also proposed:

- » Strengthen the work of the Users' Commission with dedicated technical support that works for the Commission exclusively
- » It is recommended that the Undersecretary of Social Security should provide the Commission's technical team with both administrative support and with the information and data necessary for it to conduct relevant analyses.
- » It is recommended that the Commission should possess a competitively allocated fund for studies, to be conducted in the regions by regional universities or research centers and that address and/or highlight aspects of citizen participation and of how the pension system works in the regions.
- » Establish regional user consultation groups in the country's most populous regions, including pensioners, affiliates, and beneficiaries of the Solidarity Pensions System, in order to monitor and evaluate the quality of care and services for users.

**Proposal 43: Strengthen the Institute for Social Security (Instituto de Previsión Social).**

Strengthen the IPS so as to better perform its functions and expand its range of action into new areas. The following specific proposals are presented:

- » Empower the IPS to play a more active role in access to the Solidarity Pillar, for potential beneficiaries;
- » Establish the fact that it is the IPS that will pay out all the benefits from the Solidarity Pillar—in addition to the Basic Solidarity Pensions, it should also be responsible for delivering the Top Up Welfare Complement payments when

these reach a determined minimum amount (in those cases, the AFPs should transfer resources each month to the IPS so that the IPS can deliver the payments to the affiliates);

- » Establish a new corporate governance system for the IPS, guaranteeing internal control;
- » Grant the IPS a new role as a provider of welfare education for older people. The IPS should provide social security information and advisory services for people who are approaching retirement age.

**Proposal 44: Convert the Superintendence of Pensions to a Pensions and Insurance Commission.**

The Commission proposes that the Superintendence of Pensions should be converted into a Pensions and Insurance Commission, similar in structure to the Securities Commission, with approval requested from Congress. This Commission could oversee almost the entire “value chain” of pension products, be independent of the governmental administration of the moment, and ideally be endowed with greater financing.

**Proposal 45: Develop social security education programmes.**

Develop welfare education programs, with an emphasis on preparedness, with the goal of increasing affiliation and pension contributions through educational programs in formal secondary education and technical education (Ministry of Education), as well as for workers, companies, and union organizations, thus reformulating the objectives of the FEP. The mass media should also be used. Functions should also be assigned to the AFPs.

**Proposal 46: Establish that Pension Fund Administrators (AFPs) must maintain welfare education programs.**

Pension fund administrators should maintain welfare education programs. They should develop these programs, which must not have any commercial content, and have them approved by a committee appointed by the Undersecretary of Social Security. These programs may be on-site or through distance learning, using personalized or mass media, and target affiliates in general,

even those who are not affiliated with the AFP that provides the education program. The investment that must be made by each AFP in such programs on an annual basis must be at least 33 UF per thousand affiliates. Across the system as a whole, this is equivalent to a sum of CLP 8.085 billion each year.

***Proposal 47: Identify and implement strategic objectives, goals and indicators for the program and for the achievements associated with the Welfare Education Fund (Fondo de Educación Previsional, FEP).***

Annual campaigns by the Welfare Education Fund must be based on strategic objectives to determine the segment of the population on which to focus and corresponding goals, as well as indicators to assess the functioning and achievements of the program.

***Proposal 48: Transform the current FEP into a resource fund for pilot intervention programmes.***

Transform the current FEP (Welfare Education Fund) into a resource fund to allow pilot public intervention programs to be established, designed by a public institution (such as the Undersecretary of Social Security). The decision regarding which programs should be used as the basis of a pilot program should be based on available information regarding the best practice at an international level, as well as strategic policy guidelines for the expansion of social security coverage.

The pilot programs should be designed alongside independent assessments that ensure that the impact of the programs can be measured. The Undersecretary of Social Security may recommend that successful programs be implemented on a larger scale.

## Expected Results

The expected result of the implementation of measures that set out to strengthen social security institutions, promoting social participation and welfare education, is that the institutional framework of the social security system will be strengthened. These measures also reflect one of the principles of social security; integrating and committing users through their representatives to improving the way the system works by conducting evaluations. The Commission also believes that these initiatives could bring about a general improvement in understanding among people, affiliates, contributors, and users as a whole. The goal is for these stakeholders to become aware of their rights and obligations, and for them to be provided with better tools to make use of the options available under the system. These initiatives also set out to increase the legitimacy of the system, through more active participation by citizens and better public understanding of the system. Finally, it is hoped that awareness might be enhanced regarding initiatives that have an impact on improving social security education, quantifying costs and benefits.



## J. Reduce uncertainty regarding benefits

### Background

Pension system affiliates face uncertainty regarding the mechanisms that assign pensions for a wide range of reasons.

One source of uncertainty is the risk of longevity, which affiliates when it is time for the system to pay out the pension funds. The system has three different and mutually exclusive approaches to covering this risk.

- » Pensioners who choose to take their pension as an annuity are protected by this pension modality, as this approach guarantees pension payments until the pensioner in question dies.
- » Pensioners who select programmed withdrawal and who qualify for the Solidarity Pillar are guaranteed to receive their PBS until they die.
- » Pensioners who select programmed withdrawal and who do not qualify for the Solidarity Pillar are protected by the adjustment factor introduced during the 2008 Reform. The adjustment factor withholds an equivalent sum from the accumulated balance so as to guarantee a pension of at least 30% of the initial pension until the pensioner turns 98 years old.
- » Pensioners under the old pay as you go system: Pensioners who receive IPS pensions are covered for the longevity risk so long as their old age pensions are paid through to the death of the person covered.

Taking this information into account, it is estimated that in December 2014, 14% of pensioners were covered under the programmed withdrawal system and not covered under any adjustment factor; that is, they were not covered for longevity risk.

Nevertheless, pensioners under the programmed withdrawal system absorb not only the risk of longevity, but also the risk of investment return and, as an individual, of the mortality tables. Furthermore, the calculation structure for the programmed withdrawal system results in projected pensions that drop over the course of time, which goes against an objective that pension systems

should have: to soften consumption. According to information supplied by the Superintendence of Pensions, in 2014, 62.6% of old age pensioners were under an obligation to select programmed withdrawal. Furthermore, in 2014, 40% of affiliates who were allowed to choose selected the programmed withdrawal option. In June 2015, there were 519,814 programmed withdrawal pensions paid out, and 79.3% (411,975) of those pensions had no APS payment.

Another source of uncertainty relates to pension allocation mechanisms linked to the electronic system used to find out about pension values offered under different modalities—known as SCOMP. This is an electronic system that allows future pensioners to request offers for pension values, so as to facilitate an informed and transparent decision. This system is obligatory, for both affiliates and survivor pension beneficiaries, when a pension type is chosen. SCOMP consultation is mandatory for all affiliates who could self-finance a pension greater than the Basic Solidarity Pension. However, this consultation is non-binding and solely informative, with no obligation to accept any of the offers made in the system. The information received by insurance companies and AFPs to develop offers for those who request them are wages, age, and gender of the beneficiaries.

SCOMP receives an average of 4,500 requests each month, and as of January 2015 over 560,000 requests had been entered into SCOMP (SVS Presentation to the Pensions Commission). The number of offers and the number of insurance companies that make offers vary from person to person. Thus, while some pensioners receive no annuity offers, some receive offers from over ten companies. Pensioners who do receive annuity offers, receive them from an average of around 10 companies. However, not all affiliates receive the same number of offers and some receive no annuity offers whatsoever. Indeed, in 2013 9.5% of pensioners did not receive offers through SCOMP. This final percentage of pensioners faces major uncertainty.

Another source of uncertainty arises from the use of mortality tables for the calculation of pension amounts that overestimate life expectancy published by INE. Chile currently uses a mortality ta-

ble (RV-2009) that estimates that women aged 60 have a life expectancy of 29.46 years, while men of 65 have a life expectancy of 20.07 years.

Although in 1980 the Decree Law 3.500 established that the mortality tables and life expectancy should be established by the INE based on information provided by the Superintendence of Securities and Insurance (SVS) and of Superintendence of Pensions (SP), in 2004, Law 19.934 introduced modifications to Decree Law 3500. These included that the mortality table would be specified by the Superintendence of Pensions (SP) and the Superintendence of Securities and Insurance (SVS) following discussion with the market (insurance companies, AFPs). This provision remains in force to date. In 2006-2007 the INE was requested and delivered technical comments on the mortality tables of beneficiaries and disabled people prepared by SP-SVS. In 2014 the INE sent the SVS the Complete Mortality Table, of the whole country by gender and age, for the 2009-2011 period<sup>91</sup>.

Mortality tables (Decree Law 3.500 of 1980, and Decree with Force of Law 251, of 1931) are used to calculate programmed withdrawals, the technical reserve provisions that insurance companies must set aside for life annuities, and additional contributions for disability and survivor pensions. Using a single mortality table for different, contrasting purposes creates a trade-off between balancing criteria in order to avoid excessive toughness on programmed withdrawal pensions, while paying into technical reserves appropriately.

With respect to the technical reserves, the insurance system needs to use tables to calculate the minimum mathematical reserves. Since this relates to long-term income insurance, and given the uncertainty regarding the actual mortality rate of the population in question, it is advisable to design tables that underestimate expected mortality rates, so that people are assumed to have a longer life expectancy than is actually the case (SP).

91 The INE prepares biological mortality tables; that is, a cohort exposed to risk of death is followed over the course of time, until no member survives. Deaths recorded in national statistics and the population projection is used to draw up updated mortality tables each year.

Current estimates show that life expectancy at retirement age for both men and women as estimated by the Superintendence of Securities and Insurance and the Superintendence of Pensions has increased faster than INE estimates. A projection of life expectancy for the 1950-2010 series, taken from INE-estimated mortality tables, against the values given by the SVS-SP for 2012 gives the 2025-2030 five-year period for men, and the 2050-2055 period for women.

Another source of uncertainty that has a particularly strong effect on groups belonging to lower socio-economic and education levels is the use of mortality tables that are not in line with these users' actual life expectancy, which is generally lower than for groups with higher socio-economic and education levels.

The Pension Commission requested a report with an exploratory calculation regarding life expectancy in certain selected districts<sup>92</sup>. The objective was to identify differences in average lifespans in the population correlated to districts of residence, selected using socio-economic criteria. The study found that life expectancy<sup>93</sup> by district shows a notable trend for longer lives on average across the population as a whole. In other words, the dynamics of improvement in life expectancy by district are always towards longer lives, despite many differences from one district to the next. This exploratory exercise, which investigated 22 districts, suggests that a working hypothesis linked to the variable 'income' would determine that life expectancy is longer for higher-income populations, while lower incomes would in turn be associated with shorter life expectancies<sup>94</sup>. Although the exploratory exercise did not generate a definitive answer regarding this hypothesis,

92 22 districts were selected in order to test for variations in average lifespans in the population for different districts of residence. Districts were selected using a specific set of criteria, such as: population of at least 100,000; high proportion of older people; at least five had to be districts with high average per capita income and five had to have low and moderate average per capita income; and some had to be districts with a high proportion of rural population.

93 Life expectancy at birth is an index of the average lifespan within a given population, as a result of the mortality level. It is a synthetic measurement that gauges the level of mortality with lifespan, and is not unrelated to living conditions, health, and development in a given population.

94 By conducting an analysis on a district by district basis, this hypothesis could be valid for districts that could be classified as homogeneous in terms of income

the data presented suggest that it is believable. The Commission therefore believes that further research should be conducted in this area.

Finally, the risk of solvency introduces another type of uncertainty. Insurance companies also participate in the Pension System, with three classes of products: annuities, disability and survival insurance, and the administration of voluntary social security savings. In all of these cases, the insured parties transfer their funds to the companies for them to administer the funds, in exchange for return on investment and the promise of future payment in the event of a given situation or loss (disability, retirement, or death in the case of life insurance companies).

This promise of payment is contingent on the insurance companies' financial solvency, on their capacity to meet their future liabilities. This is particularly important for the pension system, as failure to pay out on insurance such as annuities could have a serious impact on individuals and the State, as the latter is the guarantor in the event of the bankruptcy of an insurance company—which creates a major indirect liability for the Treasury.

The solvency of insurance companies depends partly on the risks that they acquire when they enter into agreements. The principal risks associated with annuities are derived from changes in life expectancy and the reinvestment risks that are generated in possible future scenarios when interest rates are lower than the interest rates were when the affiliate and the company made the agreement. The principal risk for disability and survivors' insurance stems from changes in mortality and morbidity rates.

The current system fails to provide a suitable response for all of the risks that different insurance companies face, and so it potentially risks their solvency and leads to distortions in their management. Currently, the capital requirement (risk equity) for insurance companies only provides limited coverage of their risk exposure from liabilities acquired in the course of business (technical insurance risk), ignoring operating risk and asset-based risk.

## Objectives of the Proposal

The objectives of the Commission in the field of reducing uncertainty in pension allocation mechanisms are:

- » Increase the stability of pensions received.
- » Improve competitiveness in the annuities market
- » Protect the solvency of insurance companies and the rights of insured parties
- » Take more socio-demographic variables into consideration when calculating mortality tables

## Proposals of the Commission

### ***Proposal 49: Eliminate programmed withdrawal pensions.***

Programmed withdrawal results in pensions that decrease over time and transfers the risk of longevity onto pensioners. The Commission therefore proposes to gradually eliminate the option of programmed withdrawal over the course of a period of transition.

### ***Proposal 50: Restructure the current system for Consultation and Offers of Pension Amounts (SCOMP), to allow for a bidding process for offers for annuities.***

The Commission proposes that there be an evaluation of the possibility of changing from the current electronic offer system for annuities to a system whereby offers are not requested on an individual basis but rather as an aggregate for offer requests made during a given time period; for instance, grouping all requests made in a given month (which would currently imply a figure of between 3,000 and 5,000 in the system as a whole). Participating institutions would be informed of the aggregate characteristics of the group in question, and would compete to make an offer to the group. The offer would be binding for both the company and the pensioners in the group, so companies would not be able to make

offers outside the bidding process and pensioner members would not be able to accept any such offers. The contract would be awarded to the company that offers the best selling rate for the group taken as a whole. Meanwhile, stricter requirements must be set for company solvency than are currently in place, for companies participating in such processes.

***Proposal 51: Modernize insurance company regulation by converting it into a risk-based capital system.***

A bill is currently open for debate (Bulletin No. 7958-05) that modifies the insurance law applicable to insurance companies. The bill has been approved by the House of Representatives and is in its second constitutional proceeding before the Senate Treasury Commission.

In general terms, the bill establishes that the current capital requirement should be replaced with one based on the risks accepted by insurance companies, in terms of both investments and insurance obligations. This would establish a direct relationship between the risks assumed by a company and the capital that its shareholders must maintain in the company. Capital requirements would therefore be higher for greater levels of asset and liability risk.

In terms of oversight, the initiative calls for modernization of the approach used, so as to allow the Superintendence of Pensions to act in a preventive manner by requiring companies to correct their management to reduce risk before it materializes. In other words, it allows the regulator to act in a preventive capacity, issuing instructions to insurance companies.

These powers are fully justified considering the importance of the insurance sector in the pension system, the fact that social security provisions are State-guaranteed, and, in general, the significance of the insurance sector for the development of the country's economic activity.

The Commission believes that this bill captures the spirit of this proposal.

***Proposal 52: Evaluate the use of life expectancy tables differentiated by educational level or average income.***

The Commission proposes an evaluation of the use of life expectancy tables differentiated by educational level or average income for longevity, taking into account inter-generational transfers.

***Proposal 53: Review current mortality tables, aligning them with life expectancy, as published by the INE.***

The Commission proposes the implementation of a fundamental review of the mortality tables currently in use, as applied to calculate pensions in Chile, aligning them with life expectancies in the country as a function of demographic variables as studied by the INE, with the condition that the tables produced must not be differentiated by sex. It also proposes a review of associated legislation that allows the SVS to generate these tables, instead of the INE.

## Expected Results

The Commission hopes and believes that these proposals would reduce the risk of longevity associated with programmed withdrawal pensions. It is also hoped that group bidding processes using SCOMP would increase pension payments for members of each group by reducing brokerage expenses and perhaps by cutting administration costs associated with individual applications. In turn, the modernization of regulators' activities will help reduce associated solvency risks. The evaluation of using life expectancy tables differentiated by educational level or average income, if accepted, would be expected to increase equality in the pension system by recognizing the lower life expectancy of those who have had lower earnings during their working careers, or had less access to education. Finally, a review of current mortality tables to align them with life expectancies as published by the INE would have the goal of increasing coverage for the risk of longevity.



## K. Safeguard and standardize social security rights

### Background

Situations exist wherein individual pensioners and workers have access to different types of social security benefits. Specific rules on contributions and retirement for affiliates engaged in heavy work, due to the additional burden of those activities. There are also disparities in the social security rights of the general public, such as the two types of disability pension frameworks that face affiliates with a single problem: the loss of their ability to work. There is, for example, Law 16.744 on Workplace Accidents and Illnesses and there are also benefits for lay disabilities that are granted via Decree Law 3500, as well as the social security system of the Armed Forces and Police. Lastly, there are reparation pensions granted for political reasons, which are currently included in calculations that determine a person's eligibility to access to the Solidarity Pillar. This situation highlights the need to protect the rights both to political reparations and to access social security benefits.

### Heavy work

In 1995, Law 19.404 was passed, introducing modifications to the Decree Law 3.500 of 1980 to include the possibility of early retirement for those engaged in heavy work<sup>95</sup>. This legislation establishes an additional contribution based on 10% of workers' salaries, in order to allow those people engaged in heavy work to retire early. In general, this contribution will be equivalent to 2% of the taxable income to be paid by the employee and 2% paid by the employer. Workers who have made heavy work contributions at the 2% level have a right to bring forward their retirement date by 2 years for every 5 years of making

these extra contributions, with retirement taken up to a maximum of 10 years early, and contingent on having amassed a total of twenty years of contributions or applicable services in any of the social security systems by the time they retire. Meanwhile, this benefit shall be for 1 year per 5 years worked, with retirement brought forward a maximum of 5 years, for workers who paid an additional contribution of 1%.

The following table shows the pension percentage obtained when applying the early retirement benefit, depending on extra contributions made and the period during which they were paid. "Equivalent rates" are also presented, defined as the extra contributions that would be necessary over and above the current mandatory 10%, in order to achieve a base scenario in which there is no extra contribution and the worker retires at the legal retirement age (old age under the normal system). The table shows the results for men.

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<sup>95</sup> Although no international consensus exists regarding definitions of heavy work, in Chile the term is understood to apply to positions that lead to accelerated wear on the body, intellect, or mind, generally leading to early aging, even when no occupation illness is caused. The National Ergonomics Commission (CEN) is the entity tasked with determining which jobs are classified as heavy work. It draws up a list of jobs that qualify as heavy work and another list of jobs for which this classification was rejected, based on physical, environmental, organizational, and mental strain. As well as classifying jobs as heavy work, the CEN is the body that determines the corresponding percentage of additional contribution and the amount that must be paid into the individual capitalization account.

 **Table 18. Pensions under a regime of an extra 2% and 4% of contributions**

	Extra contributions 2%			Extra contributions 4%		
	Retirement age	% increase	Equivalent rate	Retirement age	% increase	Equivalent rate
<b>No extra contributions</b>	65 years	100%	0,00%	65 years	100%	0,00%
<b>5 years of extra contributions</b>	64 years	97%	3,30%	63 years	94%	6,79%
<b>10 years of extra contributions</b>	63 years	93%	3,81%	61 years	86%	8,08%
<b>15 years of extra contributions</b>	62 years	88%	4,38%	59 years	78%	9,57%
<b>20 years of extra contributions</b>	61 years	84%	5,01%	57 years	70%	11,29%
<b>25 years of extra contributions</b>	60 years	79%	5,70%	55 years	62%	13,27%

Source: Office of the Superintendence of Pensions

It may be observed that the current extra contribution of 2% or 4% is not sufficient to offset the reduction in capital accumulation and the greater number of years for which a pension must be financed. In an extreme case, if an affiliate brings forward their age of retirement by the maximum, 5 or 10 years depending on the applicable extra contribution rate, the pension obtained under the heavy work framework would be 79% and 62% of the normal retirement pension, respectively.

Meanwhile, the “equivalent rate” of extra contribution, or the rate required so as to achieve a pension equal to that payable under the normal framework, would be between 3.30% and 5.70%, depending on the retirement age, for cases in which the ratio between years of extra contributions and years of early retirement is 5 to 1. Meanwhile, for a ratio of 5 to 2, the extra contributions required would range from 6.79% to 13.27%, depending on the number of years retirement is brought forward.

Therefore, current additional contribution rates (2% or 4%) would not be sufficient to offset the negative effects of bringing retirement forward. This would create an unfavorable social security situation for those engaged in heavy work.

#### **Disability pensions: Law 16.744 and Decree Law 3.500**

Two bodies of law currently exist for the classification and provision of disability benefits: Law

16.744, which establishes regulations regarding accidents in the workplace and occupational illnesses, and Decree Law 3500. The former provides total and partial disability pensions for severe disability, when workers suffer permanent occupational disabilities, depending on the level of impact on their earning capacity and/or dependency, as a result of a workplace accident—defined as any injury that a person suffers as a result of or during work, leading to disability or death. The second framework is under Decree Law 3.500, which provides disability pensions based on general loss of capacity to work. This difference in definitions leads to different types of expertise among professionals in the bodies that classify applicants under the two legal frameworks for disabilities that do not relate to workplace accidents.

One of the principal differences between the two regulations is the degree of gradation in the classification of disability. The workplace accident law provides benefits to persons with less than 50% disability, while Decree Law 3.500 provides benefits only to those whose level of disability is greater than 50% (through loss of capacity to work by at least two thirds, and loss of capacity to work by more than fifty percent but less than two thirds).

Given these differences, persons with a level of disability lower than the 50% stipulated under Decree Law 3.500 receive less protection, as they are not provided with the same capacities to reintegrate into the workforce and are not pro-

vided with any economic aid. Similarly, Decree Law 3.500 does not include the category of “major disability” as is included in Law 16.744 which provides additional aid for those who need help for the basic activities of daily life.

This disparity in benefits and protection offered under different national social security regulations must be reviewed and reconciled.

Another discrepancy in benefits granted under these two legal regulatory frameworks for disability in terms of safety is that the pensions granted under Law 16.744 are paid until legal retirement age. On reaching legal retirement age, recipients of such pensions must take an old age pension as stipulated in Decree Law 3.500 of 1980, leading to a major drop in the amount received. This is because of: (i) the calculation formula used for lay pensions, (ii) transfers from a system of defined benefits to one of defined contributions that result in self-financed pensions, which, together with the recipient’s inability to generate greater income so as to offset the difference, exacerbates the impact on the disabled worker.

Pensions for workplace accident disability are subject to contributions to the pension system as stipulated in Decree Law 3500, paid by the worker in question, for the value of that pension. In contrast, affiliates of the former Social Security

Funds administered by the IPS are protected by law: their old age pensions will not be lower than what they have received as disability benefits. Old age pensioners under Decree Law 3.500 who continue to work and who sustain a workplace accident leading to disability under these conditions may receive both pensions, regardless of their age, with the pension granted under 16,744 being extended for their life in this situation.

#### **Exonerated political prisoners and political reparations laws:**

Citizen demand led to the creation of “pensions” for exonerated political prisoners. These non-contributory “pensions” for exonerated political prisoners are not actually pensions, they are a form of political compensation. Nonetheless, these “pensions” received under Laws 19,123 and 19,980 (the Rettig Laws), Law 19,234 (Exonerated political prisoners Law), and 19,992 (Valech Law) are currently included in calculations for the Self-Financed Reference Pension (PAFE).

The number of people currently receiving pensions under Laws 19.123 and 19.980 (the Rettig Laws), Law 19.234 (Exonerated political prisoners Law), and 19.992 (Valech Law) and/or who are or have been beneficiaries of the Recognition Bonus for exonerated political prisoners were calculated and detailed in the table below:

N° of pensions paid			N° of affiliates
Law 19,234 - non-contributory pensions	Law 19,123 and Law 19,980	Law 19,992	Right to Recognition bonus for exonerated political prisoners
75.452	2.206	26.526	26.531



A single person may receive pensions under more than one reparations law, and may also be entitled or have been entitled to a Recognition bonus for exonerated political prisoners, so one individual may appear in more than one of these categories.

With double accounting removed, information available as of July 2015 thus shows that the total of 129,521 potential beneficiaries of this measure.

### Armed Forces

The ILO states that “equal treatment is a guiding principle of social security” (Greber, 1997). This principle applies to pension programs for powerful groups that have access to pensions and/or social security benefits that are far more generous than those provided under the general system (even excluding those programs targeting excessively heavy or dangerous work), the costs of which are financed largely by the treasury, that is, by the population at large, including the uninsured and those with insurance who are subject to far more demanding requirements and relatively meagre payouts (see the Document on principles of social security, Mesa-Lago and Bertranou, 2015).

The Chilean pension system does not currently comply with the principle of uniformity of social security rights, due to the existence of differentiated social security regimes - one for civilians, and another for members of the armed forces and police (CAPREDENA and DIPRECA). The pension system reform that took place under the dictatorship brought deep-seated changes to the civilian pension system; many separate pension systems were closed down and integrated into a unified system with standardized eligibility conditions. Nonetheless, the armed forces and Carabinero police, and corresponding personnel, were excluded from the private system and to this day maintain their former frameworks for social security defined by law and more generous pensions, largely subsidized by the State.

The armed forces and the police receive greater pensions than are provided under the general system, with public subsidies that are greater than the entire cost of the 2008 re-reform: 0.9% as opposed to 0.74% respectively in 2012.

It should also be noted that when people who leave the armed forces, they join the labor market and participate in the private system. The two different pension systems should be integrated into the general system of individual accounts, eliminating or reducing the public subsidies granted, establishing suitable payments into the system by affiliates and by the State in its capacity as their employer.

### Objectives of the proposals

The Commission proposes five measures to address these issues and resolve the situations discussed, thus standardizing social security benefits and safeguarding the social security rights acquired.

### Proposals of the Commission

***Proposal 54: Repeal the wording of Article 12 of Decree Law 3.500 that makes for those with disability benefit incompatible with the old age pension, ensuring that the amount of the disability does not decrease when an affiliate access their old age pension.***

Repeal the incompatibility indicated in Article 12 of Decree Law 3.500, continuing the disability pension as an old age benefit, safeguarding the full amount of the work-related pension as a defined benefit, with no possibility of reduction or replacement, of the full amount of the lay pension (such as the disability pension), if this is more favorable to the worker, who will maintain their classification as a beneficiary under Law 16.744.

To that end, the funds accumulated in the workers' individual AFP account should be transferred to the IPS. The IPS will manage these funds and contribute the difference to complete the pension, in accordance with its obligations as an Administration Body under Law 16.744, which is required to make the full payment (including the balance) of this old age pension, for the worker's life. This system should be financed by extending the corresponding obligation of the employer under whose care the worker in question contracted the corresponding occupational illness or suffered the applicable accident to pay into the system, in accordance with the relevant provisions of Law 16.744 for these purposes.

A bill with this objective is currently before the Senate (Bulletin No. 8971), although the bill proposes an alternative mechanism to transfer the funds and does not include a provision to allow workers to maintain their status as beneficiaries under Law 16.744.

**Proposal 55: Review qualification mechanisms, standardizing disability percentages, procedures, and the institutions empowered to classify cases in the two systems.**

Classification of labor disability is currently defined in terms of the loss of a specific job, as established in Articles 59 and 60 of Law 16.744. Meanwhile, standard disability under Decree Law 3.500 is assessed in terms of general loss of the capacity to work. These different visions require different types of expertise among professionals in the entities that classify applicants for disability pensions under the two systems. This measure is intended to reconcile and standardize the procedures used to determine and review disability classifications in the two systems.

**Proposal 56: Increase the contributions paid by workers and their employers for heavy work and moderately heavy work.**

**Proposal 57: Establish that the benefits received under Laws 19.123 and 19.980 (the Rettig Laws), Law 19.234 (Exonerated Political Prisoners Law), and 19.992 of 2004 (Valech Law) should be classified as reparations -not as pension benefits-, thereby improving beneficiaries' access to solidarity benefits.**

The benefits provided under Laws 19.123 and 19.980 (the Rettig Laws), Law 19.234 (Exonerated political prisoners Law), and 19.992 of 2004 (Valech Law) shall be classified as reparation indemnity for the purposes of compatibility with benefits provided under the solidarity pension system. Therefore, the amounts received as reparations shall not be included when determining whether people belong to the poorest 60% of the population. Moreover, the reparation benefits awarded under these laws should also be excluded from the calculations used to determine the Self-Financed Reference Pension (PAFE). This measure will improve the access of beneficiaries of these special laws to benefits under the Solidarity Pension System.

**Proposal 58: Although the mandate of the Commission refers to Decree Law 3.500 and Law 20.255 (on the civilian pensions system), the Commission considers that the Armed Forces, Carabineros and similar bodies should, in general, receive the same treatment regarding affiliation and contributions as other workers, in accordance with the specific characteristics of their occupation.**

## Expected Results

The objective of the aforementioned measures is to safeguard the social security rights that Chileans have acquired, to standardize benefits, and to resolve specific inconsistencies in the social security system.

The proposal on heavy work sets out to increase the balance in the individual accounts of workers engaged in heavy work and to resolve regulatory issues that make it difficult to classify the workers and maintain them in the appropriate category over time.

The proposed measures regarding disability benefits are designed to end the asymmetry that exists regarding disabilities that are work-related and those that are not, guaranteeing that injured workers receive the same levels of income and pensions as are provided under Law 16.744. The proposal also aims to standardize the classification of non-workplace disability and social security for accidents at work, reconciling and coordinating procedures.

The proposal on pensions associated with political reparations laws seeks to recognize and safeguard the condition of these political benefits as political reparations.

Finally, the recommendation to incorporate new generations of the Armed Forces, Carabinero and PDI police forces, Gendarme, penitentiary officers and similar institutions into the general social security system seeks to bring the Chilean system into compliance with the ILO principle of uniform treatment, and reduces the current fiscal cost required to finance the separate system for the Armed Forces.





# EXPECTED FISCAL COST AND IMPACT OF THE COMMISSION'S RECOMMENDATIONS

## VIII. EXPECTED FISCAL COST AND IMPACT OF THE COMMISSION'S RECOMMENDATIONS

This section provides an initial analysis of the expected impact and the fiscal cost of the 58 specific proposals recommended by the Commission. The analysis should be considered preliminary, especially with regards to the projected impact of the proposals, which could be refined by a consideration of all the proposals together as a whole.

The above notwithstanding, we can conclude that the estimated annual fiscal cost of the specific recommendations of the Commission would be around 0.4% of GDP (close to US \$ 1,000 million annually).

In addition, these estimates indicate that if the proposals are implemented, pensions and replacement rates would increase. For men, replacement rates would increase by about 13.5 percentage points, while for women, they would increase by about 29 percentage points. These increases are significant when compared to the current gap between the Pension System's replacement rates and the average replacement rate of OECD countries.

The first section, which assesses the effects of the proposals on future pensions, was written with the assistance of the Superintendence of Pensions. The second section, which analyzes the fiscal costs of the proposals, was written with the technical support from the Budget Office.

### A. Effects on future pensions

To assess the potential effects of specific reforms proposed by the Commission, we were assisted with technical support from the Superintendence of Pensions. Some of the simulations that helped quantify the expected effect of the specific proposals on expected pensions and the system's replacement rates are explained below.

#### 1. Strengthening and expanding the Solidarity Pension System

There is a group of proposals that are focused on increasing the benefits provided by the current Solidarity Pillar and on increasing the pillar's coverage. Proposal 1 seeks to increase this coverage from the current 60% to 80% and Proposal 2 seeks to increase the amounts of the Basic Solidarity Pension and the PMAS by 20%. Simulations of the effect of both proposals together based on a model of projected pensions for workers who will retire between 2025 and 2035 show an increase in the average pension of 14.1%. This increase differs significantly between men and women: for men, pensions increase by 12.2% and for women pensions increase by 16.7%.

Regarding the impact of both measures on average replacement rates compared to a worker's last taxable income, to their average income over the last 10 years prior to retiring, and to the average income of workers in their field increased 7.5, 5.6 and 7.5 percentage points respectively<sup>96</sup>.

This increase, as in the case of pensions, is greater when considering median replacement rates, which increase 7.9, 6.2 and 8.0 percentage points respectively.

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<sup>96</sup> The medians of projected replacement rates for the period 2025-2035, -under a scene without the application of the offers with regard to the average revenue of last ten years and of the complete career -are equal to 37.2 % and 50.6 % respectively.

## 2. Strengthen the contributory pillar, expanding coverage and contribution density

Proposal 6 maintains the obligation established in Law 20,255 of self-employed workers to pay contributions, but it makes the process more gradual, in order to strengthen the contributory pillar and extend the system's coverage.

To quantify the impact of the measure, we set the requirement to be gradually and linearly implemented over 10 years beginning in 2015. The simulation looked at individuals' accumulated balance at the time that they reached the legal age of retirement, taking into account the gradual implementation described above and assuming that they only contributed the legally required amount. If, for different age and gender profiles, one takes the initial average balance of self-employed workers in December 2014, and compares the final pension amount with the implementation of the legal requirement as compared to a situation without the legal requirement, the final expected pension for self-employed workers between 25 and 50 years old increases between 271% and 24%, depending on the profile. While if the legal requirement were incorporated gradually, the increase in the pension amount would be more moderate, fluctuating between 232% and 16% depending on the age profile.

## 3. Increase savings in the contributory pillar

### a) Increase the contribution rate

There is a set of proposals aimed directly at increasing the amounts contributed into affiliates' individual accounts. Specifically, proposals 9, 10, 11, 12 and 13 refer to the increase and the use of the contribution rate, the increase of the tax base stemming from the restriction of untaxable allowances and the modification of the current taxable limit.

Increasing the individual contribution rate (proposal 9) with the current tax base, will result in an increase in social security savings, and, therefore, in an increase in self-financed pensions.

The long-term impact of increasing the contribution rate is homogenous, considering affiliates who contribute at the increased contribution rate to the pension system during their whole life. An increase of 1, 2, 3 and 4 percentage points of the contribution rate (proposal 10) would increase self-financed pensions in the long term by 10%, 20%, 30% and 40%, respectively.

However, the effects in the short and medium term will depend on the balance that individuals have already accumulated. Simulations based on a model of projected pensions show that an increase of 1, 2, 3 and 4 percentage points of the contribution rate will increase the average self-financed pensions for pensioners between 2025 and 2035 by 2.4%, 4.6%, 7.1% and 9.5%, respectively. The simulated effects for women would be larger in comparison to men: 3%, 6%, 9% and 12.2%, mainly due to the fact that the initial basis for average pensions is smaller for women.

The increase in pension amounts due to higher contribution rates decreases as the number of months of contributions increases. For pensioners who retire between 2025 and 2035, those who contributed for between 0 and 174 months during their work life (first quartile), an increase in the contribution rate of 1, 2, 3 and 4 percentage points would result in average increases of self-financed pensions by 8%, 16%, 24% and 32%, respectively. For the last quartile (those who contribute during their working life for 400 or more months), an increase in the contribution rate of 1, 2, 3 and 3 percentage points would increase the average self-financed pensions by 2%, 4%, 6% and 8%, respectively.

### b) Limit non-taxable allowances on income and increase of the taxable limit

Proposal 12 aims to establish a norm in order to limit the non-taxable part of affiliates' income. Specifically, leaving aside the different regulations in place regarding non-taxable allowances for affiliates who work for the Central Administration of the State and Municipalities, as well as the regulations established for specific workers in the Labor Code, the proposal is to limit non-taxable allowances to no more than 5% of an affiliate's monthly income for the purposes of pensions.

Introducing limits to non-taxable allowances will generate direct increases in the tax base, which at the same time will result in larger social security savings, and therefore in higher self-financed pensions. In the public sector, it is estimated that around 18% of gross average income comes from non-taxable allowances. This factor is less pressing in the private sector and is only between 6% and 7%.

The effect of an increasing the tax base by limiting non-taxable allowances on self-financed pensions can be approximated as changes in the contribution rate. In this sense, a limitation of non-taxable remuneration to 5% would increase the tax base of the public and private sectors by 13 and 2 percentage points, respectively. In theory, this larger tax base would result in an increase in the contribution rate by 1.3 and 0.2 percentage points. This theoretical increase in the contribution rate would increase self-financed pensions between the years 2025 and 2035 of the public and private sector by approximately 4.6% and 0.9%, respectively.

Proposal 13 aims to change the maximum limit for pension contributions from the current limit (73.2 UF) and standardize it with the limit set for unemployment insurance (109.8 UF). This increase in the cap on deductions will generate a direct increase in the tax base, which, in turn, will result in increased social security savings and in self-financed pensions. Based on information from the Unemployment Insurance Office (SC) records, it is possible to determine the percentage of the population affected by the current taxable limit of the pension system. This insurance has a taxable limit, which is 50% higher than the current limit on pension contributions<sup>97</sup>. The percentage of the population of contributors affected by the cap on contributions has grown over time, and includes more than 13% of contributors per year.

In order to estimate the effect of the proposal, we performed a simulation based on data from the Unemployment Insurance Office. The simulation focused on individuals who have made at least 24 contributions since they became affiliates and who have income that has reached the pension's taxable limit for at least 15% of the

contribution periods in the last 24 months. The effect of increasing the taxable limit was simulated, taking as a starting point the accumulated balance of the pension system for each individual in this group. The result shows that the measure would increase an individual's balance at the legal retirement age by between 20% and 10% for individuals between 25 and 40 years old, respectively.

Moreover, according to simulations performed based on administrative data, in the medium term, it is highly probable that age cohorts who are currently between 25 and 35 years old that belonging to the middle deciles will reach the taxable limit within the next ten years due to their income history in recent years. Therefore, the measure will have a larger impact in the long term than in the short term, due to growing income profiles within the younger population placed in the middle deciles.

### **c) Decrease social security evasion and avoidance**

Proposals 14 and 15 regarding social security evasion and avoidance are aimed at reducing the effect of this problem on the pensions that retirees receive. These measures will generate a wider array of effects on the pension system, from directly increasing social security savings (and therefore improving self-financed pensions), to improving the decisions taken by the individuals.

According to data from the 2013 CASEN survey, 17.5% of salaried workers are in a situation involving social security evasion, either through social security evasion (dependent worker with a contract but without contributions) or social security avoidance (worker without a contract). Simulations based on pension forecasting models from the Pension Superintendence show that for the pensioners in 2025-2035, a 10% increase of the contribution density (measured as a homogeneous increase of the likelihood to contribute at each moment of the cycle) will increase the replacement rate by about 0.7 percentage points. Therefore, decreasing evasion and elusion will increase the replacement rates.

<sup>97</sup> At the time this report went to press, the taxable limit for the pension system was 73.2 UF, and the limit for unemployment insurance was 109.8 UF.

#### d) Extend mandatory contributions until the actual retirement age

Proposal 16 is related to extending mandatory contributions to the pension system until the real age of retirement. In order to estimate the impact on pensions for this proposal, we simulated the effects for individuals under certain assumptions<sup>98</sup> and scenarios of contribution density, with the following figures for contribution density: 25% observed average by gender; 75% and 100%<sup>99</sup>. During the years retirement is

postponed past the legal retirement age, the contribution density is assumed to be 100%.

Under these assumptions, the simulation reveals that the effect of making contributions mandatory until the actual age of retirement (one additional year for men and women) decreases with the contribution density, to the range of 1.7% (100% contribution density) to 6.6% (25% contribution density) for women and to the range of 1.3% (100% contribution density) to 4.7% (25% contribution density) for men.

 **Table 19: Increase in pensions subject to contribution density**

	Single Women				Single Men			
	0,25	0,47	0,75	1	0,25	0,56	0,75	1
<b>Density</b>	0,25	0,47	0,75	1	0,25	0,56	0,75	1
<b>Balance Delta</b>	6,6%	3,5%	2,3%	1,7%	4,7%	2,2%	1,7%	1,3%
<b>Voluntary Pension</b>	74.485	142.367	218.316	290.783	116.437	251.366	320.386	427.423
<b>Mandatory Pension</b>	79.421	147.303	223.252	295.718	121.965	256.894	325.915	432.952

Source: the Commission's own calculations

A second scenario, with the same assumptions described above, but assuming that an individual contributes with the same density during their year when retirement is postponed as they did throughout the work life, results in the fact that the effect of making contributions mandatory until the actual age of retirement (one addition-

al year for men and women) reaches 1.7% for women and 1.3% for men. It is noteworthy that, given the assumption that contribution rates remain constant during the year of postponement of the retirement, the effect of the measure does not change with different densities as it does in the first scenario.

<sup>98</sup> Assumptions: age of entry to the labor market at 25 years old in 2017, taxable income at age 25 reaching 20 UF, with a real growth rate of 2% until 55 years of age and 0% from 56 years of age until retirement for both women and men, annual 4% returns of the funds and the actual retirement age is 61 years old for women and 66 years old for men.

<sup>99</sup> Random density is applied during their active life, as to not confuse the contributions' timing effect due to fund returns.

## 4. Increase the legal retirement age and introduce incentives to work by older people

The proposals related to modifying the legal retirement age were also assessed.

### a) Match the retirement age of men and women

The effect on pensions of proposal 17 about bringing women's legal retirement age in line with men's was evaluated both in isolation and also in conjunction with other proposals. In order to analyze the effects on pensions, a simulation was carried out, taking into account the nature of affiliate income, contribution density and the accumulated balance (according to administrative data) of women born between 1970 and 1975<sup>100</sup>. To determine the effects of the proposal in isolation, the increase in pension amounts was analyzed with respect to the necessary capital unit (CNU), as well as with respect to the increase in an affiliate's accumulated balance. This allowed us to closely approximate the minimum effects of the proposal, even in cases where women did not contribute from 2015 onwards. In order to determine the compound effects of Proposal 17, we referred to the current contribution density to examine other periods.

<sup>100</sup> These cohorts are related to the generation that would go through the transition phase of the reform, the effect of the measure can be observed if the generation born between 1970 and 1975 retires at age 65.

### Isolated effects

Given the decrease of potential years that have to be taken into account for pension payment, the pension increases by approximately 10% for the decrease in the CNU. The pension is a linear function of the CNU, therefore, if the CNU drops by 10%, pensions will increase by 10%. This can be seen in the following table:

 **Table 20: CNU variation by age cohorts**

Cohort	Legal retirement age		Δ CNU
	60 years old	65 years old	
1970	19,977	17,971	-10,04%
1971	19,991	17,987	-10,03%
1972	20,005	18,002	-10,02%
1973	20,019	18,017	-10,00%
1974	20,033	18,031	-9,99%
1975	20,047	18,046	-9,98%

Source: the Commission's own calculations

Increase in account balances: even if women did not generate new contributions from 2015 on out, their balances would increase by 22%. These figures are obtained by taking the actual balance of age cohorts on December 2014 and applying a real annual return rate of 4%.

### Composite effects

Based on administrative data, we see that on average there are 70,000 women in the 1970-1975 cohort, with average incomes (as of December 2014) of \$568.000 CLP, with a contribution density reaching 0.65 and an average account balance (as of December 2014) of \$7.426.333 CLP. With this information, we used certain assumptions<sup>101</sup> to project the effect of the proposal and saw that pensions increase, on average, by 36.6%, with the median increase at 36.7%.

<sup>101</sup> The assumptions include; a real increase of salaries of 2% until the age of 55 and 0% until the legal retirement age, 4% return rate of the funds, 2.99% technical interest rate of programmed withdrawal, contribution density equal to the average density of cohorts from 2014 until the age of retirement, with women married to husbands two years older than her.

## **b) Periodically review the retirement age**

Proposal 19 specifies the increase of the legal retirement age as a function of life expectancy after the ages by gender have been matched. In the year 2016, new mortality tables calculated by the SVS/SP will come into force. According to preliminary results, life expectancy (EV) of pensioners at 65 years of age will increase by 0.94 years in the case of men and 1.52 years in the case of women in comparison to current tables. This increase of EV will result in a decrease of new pensions by 2.7% for men and 3.8% for women, both with spouses, assuming an interest rate of the programmed withdrawal of 3%. If the retirement age were 66 years of age for both genders, the effect would be reversed, resulting in a pension increase of 3.5% for men and 2.3% for women, with a 4% annual return rate of the funds and no new contribution during the year on which the retirement was postponed. This is due to the fact that the increase in pension age mostly compensates for the increase in life expectancy, and the return rate of the additional year increases an affiliate's accumulated balance at the moment of retirement.

This effect increases by 0.1 percentage points for men and 0.4 percentage points for women for each additional percentage point of the interest rate. Therefore, the effect will increase by approximately 1 percentage point if the return rate increases by 1 percentage point.

## **5. Reduce the risks to which affiliates are exposed**

We analyzed two proposals regarding the decrease of risk to affiliates' accumulated funds.

Proposal 26 is aimed at decreasing the age for voluntary participation in Fund A. At the same time, it proposes to inform affiliates about the largest drops in the fund's history. By restricting voluntary access to the riskiest fund (Fund A) to at least 20 years before individuals reach the legal retirement age, the maximum risk to which an affiliate could be exposed is decreased, thus limiting the riskiest possible strategy. This decreases the variability of the expected replacement rate for an individual taking on the maximum risk throughout their life by 14.3% and 14.7% according to gender, contribution density and income profile, while the subsequent decrease in the expected replacement rate would.

Proposal 27 proposes to reduce the maximum risk to which social security savings could be exposed during the 20 years prior to an affiliate's legal retirement age (affecting affiliates as they turn 40). The proposal's first part, regarding the restriction of access to riskier funds at older ages, shows us that by limiting voluntary access to the riskiest funds (Fund A) at least 20 years prior to reaching the legal retirement age, and to the riskier fund (Fund B) at least 10 years prior to reaching the legal retirement age, and also by allowing for a maximum of 50% of the funds to be invested in Fund C, the maximum risk to which any affiliate could be exposed is decreased, therefore restricting the riskiest strategy possible. This decreases the variability of the expected replacement rate for an individual taking the maximum possible risk throughout their life by 29.5% to 34% according to gender, contribution density and income profile, while the subsequent decrease in expected replacement range would not surpass 7% - 8%.

This measure also limits the risk of suffering through a crisis at an advanced age, when the affiliate does not have enough time to recover from the losses. This is because when a person is 20 years away from retirement, if there is any financial crisis during those 20 years then an investment strategy that does not include Fund A at any time (and excludes Fund B in proximity of retirement) is better than an investment strategy based on funds A and B (like the current maximum risk strategy), in terms of expected replacement rate and standard deviation associated to that replacement rate.

The second part of the proposal is to decrease the age at which, if affiliates have not actively chosen a fund, they are assigned to Fund D by default by 10 years. This decreases the risk of affiliates facing a financial crisis at an advanced age, particularly in the range of 10 to 20 years before retirement (between 45-55 for men, and 40-50 for women). The impact of this proposal, as measured in relation to the current default strategy, is a decrease of 20% of the standard deviation of the expected replacement rate, as well as a decrease in the expected replacement rate of about 5%, depending on the affiliate's profile. According to our simulations of expected replacement rates, if the individual faces a financial crisis shortly prior to their retirement, the current default strategy delivers a smaller real return

with a higher level of risk associated with any strategy. This includes strategies that are based on Fund E, and that transfer the funds through funds B, C, D and E gradually along an affiliate's active life. This shows that the inclusion of Fund E generates strategies that better cover the risk of crises at ages that are close to an affiliate's retirement.

## 6. Increase competition in the AFP market

The impact of proposals relating to competition and the industry is discussed below:

### a) Extend the current bidding process for new affiliates to a portion of the old affiliates

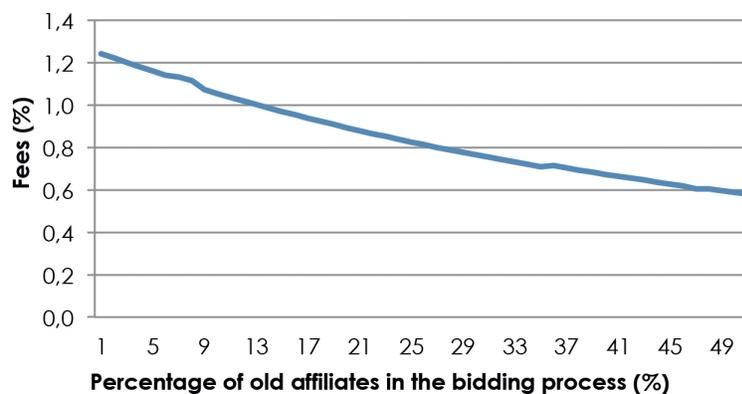
Proposal 29 aims at extending the current bidding

process that brings in new affiliates to join a portion of already-existing affiliates. Initial estimates show that by auctioning 10% of the portfolio of old affiliates, within 10 years, fees can be expected to drop by 16.53% from the average fees in the industry. As is to be expected, the decrease in fees is grows as does the size of the portfolio of old affiliates to be auctioned.

Estimates developed by the Superintendence of Pensions show that by auctioning 10% of the old affiliates, fees are expected to drop by 16.53% from the average fees in the industry within a 10 year period. The following graph shows the way in which the average industry fee decreases as the percentage of old affiliates involved in the bidding process increases. The fee is measured as a percentage of taxable income<sup>102</sup>.

Graph 14:

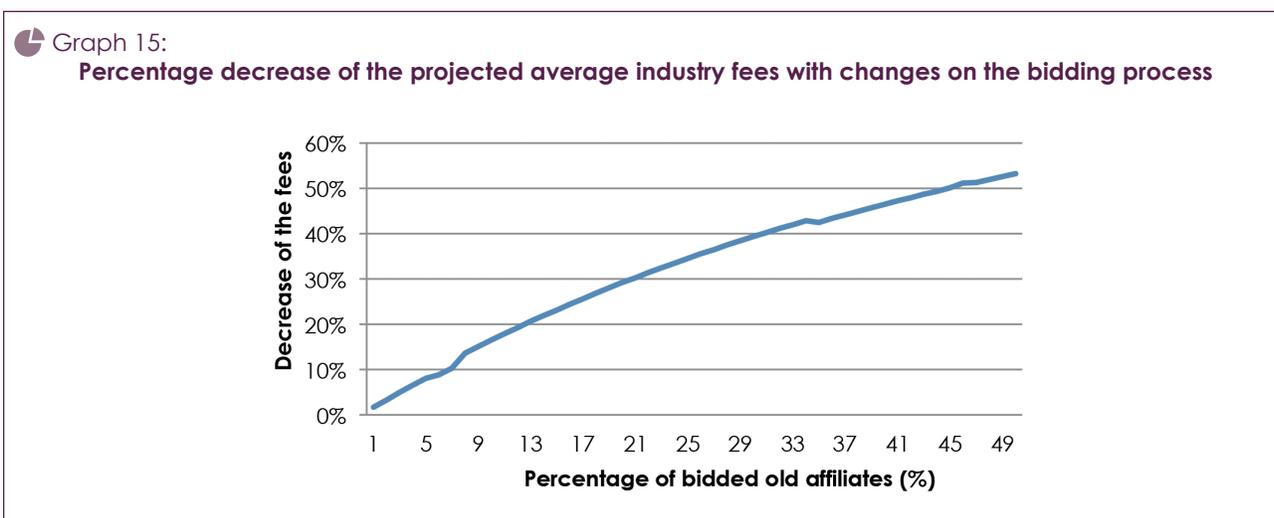
Projected average industry fees with changes on the bidding process



Source: Superintendence of Pensions

102 This simulation makes the following assumptions: a) the auction is held every two years, b) the marginal costs are known and equal for all AFPs, c) there is no entry of new AFPs to the market, d) the growth rate of new affiliates is 10% every two years, e) AFP profit is approximated to the fee charged to the client portfolio, f) there is no transferral between AFPs, and no affiliates in the auction choose to stay in the AFP of origin. This last assumption can be interpreted as a net effect of transferrals that is non-existent or irrelevant.

If we compare the situation without the bidding process for old affiliates with the fee charged in each case, the results reveal that the measure decreases fees, as seen in the following graph.



Source: Superintendence of Pensions

### **b) Investment brokerage fees should be entirely financed by the AFPs and not the affiliates**

Proposal 30 is that investment brokerage fees should be taken on by the AFPs and not the affiliates, reducing total fees and making the costs of fees that are charged transparent, therefore improving the pensions of affiliates.

Initial estimates show that Fund A could have had a real annual return of an additional 0.5% if brokerage fees were not charged to the fund, which would have increased pensions between 10% and 15% if the increase in returns lasts for 30 years, depending on the return base and the affiliate's profile. However, these effects may be ambiguous if the AFP decides to minimize these costs by investing in inefficient portfolios or in any other sub-optimal ways that do not further the affiliate's interest.

## **7. Reduce the gender gap**

The following section explains impacts of some proposals and specific measures aimed at gender equality.

Proposal 34 proposes to regulate the distribution of funds accumulated during a marriage at the time of divorce or annulment of a marriage, by

dividing the contents of both pension accounts in half between the two spouses. The current regulation on civil marriage states that the division must be determined by the judge in the divorce proceeding. It is the judge, therefore, who has the power to determine what percentage of the account the compensating spouse must transfer to the other spouse to offset the economic harm of the divorce. Current compensation can be up to 50% considering the situation of the spouses during the marriage. Initial estimates based on representative individuals show that the effect of this measure would be a 6% increase in the account balances of women and 5.6%<sup>103</sup> decrease the account balances of men. This would result in an increase in pensions for women of 6% and a decrease of pensions for men of 5.6%.

<sup>103</sup> The following assumptions are considered in this estimation: entry to the market of men and women at the age of 24 and 27, with a revenue of \$225,000 and \$206,250, respectively, real growth of the remunerations of 2% up to 55 and 0% from the 56 up to the age of the retirement (both for women and for men), real profitability of the funds of 4% and density for the woman of 0.47 and for the man of 0.7. Besides, there is also assumed the fact that the average age of marriage is 30 years and that the average duration of the marriages is 7 years.

Proposal 35 suggests that the mandatory social security contributions made to each individual pension account each month should be distributed equally to each spouse's or partner's (in a situation of cohabitation or civil union agreement according to Act 20.830) account. The effects of this measure would be similar to those previously described in proposal 34.

Proposal 37 is to increase nurseries and day care centers at a national level. The main direct effect of this proposal would be to the increase of contribution density for women who leave the labor market for two years due to lacking access to nurseries and day care centers. The impact of the increase in contribution density is an increase in self-financed pensions. Given that nurseries accept children between 84 days and 2 years of age, and maternity leave is 6 months, the maximum theoretical increase of the contribution density as a result of this proposal would be the difference between 6 months and 2 years of contributions. That would mean an additional 18 months of contributions for women who left the labor market because they were unable to find a nursery for their child. For a woman who contributes between 25 and 60 years of age, has

a single pregnancy at age 27, assuming a 4% return, an increase in the wages of 2% until they turn 55 and the 0% until they reach the legal pension age, the increase in their pension as a result of the increase in contribution density would be 12% for an average woman in terms of contribution density.

## **8. Effect of the proposals in conjunction with one another**

The exercise carried out above allows to understand the expected impact of the set of specific proposals to some degree, but it will be necessary to have more time to develop a more precise estimate of the effects of the proposals.

The impact in terms of expected replacement rates for men could amount to about 13.5 percentage points (which would be an important change given that median replacement rates are projected to be about 40%). For women, the estimated effect could be twice as large, when we consider the increase in the retirement age of 5 years and the benefit of shared pension accounts between spouses.

## B. Fiscal Commitments required by the Commission's Recommendations

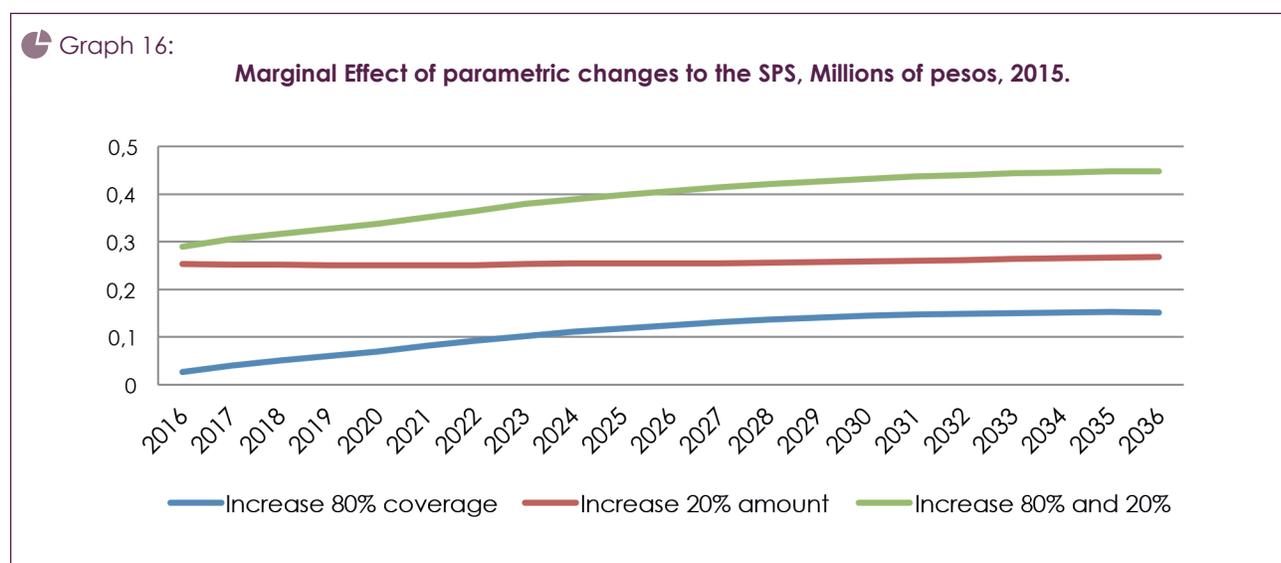
In order to increase the pensions of current and future retirees, the Commission's recommendations will require a greater amount of financial resources from both the private sector and the state. Regarding the cost to the state, below we present a preliminary estimate of the most important fiscal commitments that would come from the Commission's major proposals. The Budget Office and the Ministry of Finance collaborated on this work.

### 1. Changes to the Solidarity Pension System

The Commission recommends extending coverage of the Solidarity Pillar from the current 60% the poorest households of the population to 80% of the poorest households of the population, and increase the amount of the Basic Solidarity Pension Solidarity and the Maximum Pension for a State Solidarity Contribution by 20%.

The model projection developed in DIPRES allows us to generate a baseline scenario projection of expenditure of the SPS without reform, and also allows us to project the new expenses associated with the increase in coverage and benefit amounts. By 2013, spending on SPS represented 0.7% of GDP, of which 61.2% goes to the PBS and 38.8% goes to the APS.

The graph below presents the scenarios evaluated with respect to the baseline scenario. The blue line represents a possible increase in the targeting of SPS to 80%, keeping the amounts of PBS and the PMAS constant. The red line maintains the coverage at 60% and increases the amount of the PMAS and the PBS by 20%. The green line increases the SPS parameters by 20% and increases the targeting to 80%.



Source: DIPRES

This projection tells us that the expected cost for 2015 under the current SPS scheme represents 0.9% of GDP. With the proposed changes in targeting and amount of benefits, this projection would increase to 1.2% of GDP.

## 2. Increase in the contribution rate of the employer

The increase in the employer's contribution rate has a direct and indirect impact on the State's fiscal balance.

The first impact has to do with the increase in spending for compensation and benefits associated with the payment of salaries by the Central Government, Municipalities, Universities and subsidies. The State must spend about US \$200 million for every 1% wage increase<sup>104</sup>.

The indirect impact would come from the increase in the balances of individual savings accounts as a result of the greater number of contributions that would enter into the system. It is expected that the effect of the higher number of contributions will result in higher pension amounts, and the expenses related to the APS will also decrease.

## 3. Increase the taxable limit

In line with the increase in the contribution rate, the adjustment of the taxable limit decreases the take-home income of the people who are affected by the measure which will require the State to adjust salaries. In this regard, it is estimated that the increase in the taxable limit involves a state expenditure of US \$24.7 million per year (0.013% of 2014 GDP).

If we simulate an increase in the contribution rate of 1% for this new bracket of taxable income, the combined effect for those who are currently capped is estimated at US \$2.5 million annually.

<sup>104</sup> We must keep in mind that there are additional details relating to payment, such as in the case of persons hired under the labor code, public enterprises, and kindergartens, among others.

## 4. State AFP

According to the Financial Report related to the Bill that would create a State Pension Fund Administrator, the Ministry of Finance is authorized to "complete, within 36 months after the formation of the State A.F.P., SA, an initial extraordinary capital contribution for up to \$70 million to be authorized and regulated by the Treasury and/or CORFO, with the objective of financing the requirements of the AFP, according to the application of Article 40 of Decree No. 3500, 1980, and to finance the start-up costs."

The amount mentioned above includes the amount required in Article 24 of Decree No. 3,500 of 1980, e.g. 20,000 UF (UF).

## 5. Creation of a subsidy to encourage the employment of senior citizens

Following the model of the youth employment subsidy (Law No. 20.338), the payment structure of the Subsidy for Senior Employment (SAM) would be equivalent to 30% of a gross monthly salary, and increase with a person's gross income up to a maximum of \$188,672 per month<sup>105</sup>. Then the subsidy would remain steady between \$188,672 and \$235,840 of a person's gross monthly salary and it would finally fall to between \$235,840 and \$424,512 of gross monthly salary. The monthly payment would mean that an older worker receive 2/3 of the subsidy, and the employer would receive the remaining third.

Once the potential beneficiaries have been estimated by using projections of the population of people above the legal retirement age, and their income profiles according to data from the CASEN 2013 survey are understood, then the benefit can be targeted to the poorest 60% of the population.

In this context, it is expected that the annual fiscal cost of this benefit will be approximately \$129,000

<sup>105</sup> It corresponds to \$160,000, which is the upper cap of the top of the first section of the SEJ at the time the law was passed, adjusted according to the variations of the IPC to pesos in 2013. This adjustment is to make the data comparable to the CASEN 2013 data. The remaining amount, also equal the SEJ upper caps readjusted by the IPC to 2013 pesos.

million pesos. It is also expected that this cost will increase progressively, given that the population will experience accelerated aging in the coming decades.

## 6. Incentivize the creation of Day Care Centers

Currently, the budget allocated to the creation of day care centers under SENAMA is \$780 million, which represents an increase of 3% from last year's budget. This amount will finance, in the first stage, the care of 1,200 seniors who meet the following criteria:

- » Be over 60 years old.
- » Have a slight dependence.
- » Reside in the district where the program is implemented.
- » Belong to the first three quintiles of vulnerability, according to Social Protection Register or the instrument that replaces it.

The Day Care Centers Program provides health and social services during the day, support for the family and cultural activities. They also promote active aging, maintaining adult in their family and social environment. They operate in physical spaces that are specially equipped for the elderly and for universal accessibility. This program is run by public or private nonprofit institutions, and those who apply to for a special fund to finance projects and must be registered in SENAMA's Register of Providers of Services for Older Adults. These centers also receive technical advice and guidance from SENAMA.

Given the expected increase in demand for this service, it is important to increase the supply of public and private institutions that offer this service and increase the program's coverage to a greater number of municipalities, which will also require a major increase in the budget.

According to the latest CASEN survey, 7% of seniors are in a situation of mild dependence, corresponding in absolute terms to just over 180 thousand people. If the measure targets people who are in the poorest 60% of the population, it

has a target of 112,000 elderly—far above the current 1,200 elderly people that the program currently serves.

Given this, one criteria for setting the budget could be to increase it by 25% per year, which would triple it over five years. Under this scheme, the budget could reach about \$1.600 million more.

## 7. Social security compensation for caregivers of seniors and of people with dependencies

Currently, the Home Care for Persons with Severe Dependency Program is implemented in Primary Care Centers that are run by both municipalities and the national level Health Services. The program includes the payment of a stipend of about \$25,000 to caregivers of people with severe dependence. The total number of caregivers served by the program is presented below.

**Table 21. Number of caregivers that receive the stipends**

Year	2010	2011	2012	2013	2014	2015(*)
Total Caregivers paid	19.745	22.706	22.757	22.112	22.569	23.219

Source: Primary Care Division, Undersecretary of Assistance Networks, 2014.

(\*)DIPRES Estimate under the assumption that the stipend is maintained.

The Commission's proposal sees the primary caregiver of people with severe and moderate dependence as the beneficiaries of the stipend. According to the latest CASEN survey, the number of people with this level of dependence is equivalent to 3.2% of the population under 60 and 11.9% of the population over 60 (in total, approximately 700,000 people). The caregiver must also be a family member of the person in care. With these requirements, we estimate that the

number of potential beneficiaries of the caregivers' stipend could be 223 thousand people<sup>106</sup>. If the stipend also requires the caregiver to be registered with home care program and prioritizes the first three income quintiles, the total number of caregivers who would be eligible for the stipend could be 100 thousand people.

Under these assumptions, and considering a credit of 10% of the minimum wage for an average period of four years, the cost of the Commission's proposal would amount to \$1,156,800 pesos, 0.9% of GDP, which would be prorated as the beneficiaries retire.

The potential beneficiaries could, however, include 698,395 caregivers. This represents the total number of people with severe or moderate dependence today, a figure that will increase further considering the estimated growth of the population of older adults.

To estimate the cost of the proposal, we set the amount of the credit at the equivalent to a 10% contribution on the current minimum wage for the total months of registered caregiving (which is, on average, four years according to the National Study on Dependence). Under these assumptions, the potential cost of the measure is of MUS \$173,000, which is equivalent to 0.07 percent of GDP. This amount will be distributed annually to the caregivers who retire each year.

## 8. Summary

Considering all of the proposals discussed above, the total cost of the proposals would be about 0.62 to 0.67% of GDP. Of these, the proposal that would require more state expenditure is the proposal to increase of the contribution rate. If this proposal is not applied gradually, it would mean an increased expenditure of the order of 0.3% of GDP. The next most expensive proposals are the ones that modify the Solidarity Pension System, which, when taken together, would increase spending by 0.25% of GDP.

 **Table 22. Estimated Fiscal cost of the proposals**

Proposal	Increase in the annual gross cost (% GDP)
Increase Targeting of the SPS to 80%	<b>0,02</b>
Increase the amount of the PBS and the PMAS by 20%	0,23
Increase in the contribution rate (4%)	0,31
Increase in the taxable limit	0,01
State AFP I	0,03
Subsidy for Senior Employment	0,1
Increasing and strengthening day care centers	0,001
Social security credit to caregivers	0,07
<b>Total</b>	<b>0,62-0,77</b>

These annual costs are evaluated for the first year of implementation of the measures. In time, as we discussed above, the expenditures will increase, specifically the increase in coverage and in the amount of the solidarity pillar will increase by another 0.3 percentage points of GDP.

The above numbers do not consider the use of the Solidarity Fund financed with the proposed contribution. So, for example, if 2 contribution points go to this fund, this will translate into additional revenues of US \$1.300 million per year or the equivalent of 0.5% of GDP.

Therefore, in aggregate, the measures would cost the system about 0.4 points of annual GDP.

<sup>106</sup> This is under a scene without a focusing of the benefit and considering that of the total of major persons with moderate or severe dependence, 32 % has principal caregiver, who in addition is familiar (National Study on Dependence).





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## ➔ X. APPENDICES

### Appendix 1:

**Speech by S.E. President of the Republic, Michelle Bachelet, on signing the Decree that created the “Advisory Commission on the Pension System”**



DISCURSO DE S.E. LA PRESIDENTA DE LA REPÚBLICA,  
MICHELLE BACHELET,  
AL FIRMAR DECRETO QUE CREA “COMISIÓN ASESORA SOBRE  
EL SISTEMA DE PENSIONES”  
(MEDIDA N° 17)

SANTIAGO, 29 de Abril de 2014

Muy buenos días, amigas y amigos:

Gracias por estar aquí esta mañana. La verdad que hoy estamos cumpliendo una promesa de campaña, la medida 17 dentro de los primeros 100 días de Gobierno. Pero, por sobre todas las cosas, estamos más que cumpliendo una promesa de campaña, estamos iniciando un proceso fundamental de reflexión y de debate para que las chilenas y chilenos cuenten con un sistema de pensiones digno y adecuado a sus necesidades. Un proceso que queremos que sea altamente participativo, pero también de muy alto nivel técnico, y que nos permita hacernos cargo de las claras insuficiencias de nuestro sistema previsional.

En los años 80 se instauró en Chile un sistema de pensiones basado en la capitalización individual, con administradores privados y un Estado en un rol exclusivamente regulador.

Hoy, a más de 30 años de ese momento, es un deber revisar si este sistema ha cumplido o no la promesa con la que se puso fin al régimen público de reparto.

Para nadie es un secreto que las pensiones no están a la altura de lo que esperarían los trabajadores y trabajadoras. Además de los casos específicos de las lagunas previsionales o el trabajo en forma



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independiente, hay quienes han cotizado toda la vida y aún así obtendrán una pensión deficiente.

Por otra parte, las Administradoras de Fondos de Pensiones han perdido credibilidad en la ciudadanía, y su modo de funcionamiento merece ser analizado en detalle.

Sabemos que mejorar un sistema previsional toma tiempo. Debemos tener certeza de que las decisiones sean responsables, se sustenten en el tiempo y sean efectivamente un avance y no un retroceso para los pensionados.

El año 2008 hicimos una reforma que cambió no sólo el foco, sino una idea central: que el Estado tiene un rol importante en la situación previsional de chilenas y chilenos, y el sistema de pensiones pasó a tener un pilar solidario y a ser un derecho social garantizado.

Y los resultados están a la vista. Hoy nuestro sistema de pensiones solidarias beneficia a 1 millón 237 mil personas. Pues, ahora, 6 años después, ha llegado la hora de profundizar este proceso.

No queremos un país en que la tercera edad sea sinónimo de vulnerabilidad o desprotección, y donde la jubilación, en lugar de descanso, traiga aflicciones a las personas.

Es por eso que hoy estamos convocando a un grupo de expertos nacionales e internacionales que estudie a fondo nuestro sistema de previsión social y haga una propuesta contundente respecto a cuáles son los cambios necesarios.

Yo, para esto, quiero agradecer a la ministra Javiera Blanco, y en particular al subsecretario, Marcos Barraza, así como al ministro Alberto Arenas y todo su equipo, en lo que ha sido la identificación de los expertos y los términos de referencia y el trabajo en este sentido.



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En esta comisión van a participar expertos nacionales y extranjeros de reconocido prestigio y de diversas sensibilidades políticas. Esta comisión será presidida por David Bravo Urrutia. Les voy a pedir que cuando los vaya nombrando se paren, para que la gente los conozca, hay varios internacionales que obviamente no están hoy día acá, pero van a trabajar en comisiones, en seminarios on line, con ponencias, etc.

David Bravo Urrutia, economista, ingeniero comercial de la Pontificia Universidad Católica y master en Economía de la Universidad de Harvard. Fue fundador y director del Centro de Microdatos de la Universidad de Chile. Es integrante del Consejo Consultivo Previsional y fue miembro del Consejo Asesor Presidencial para la Reforma Previsional el 2006.

La comisión estará integrada también por Cecilia Albala Brevis, médico y especialista en salud pública, fue “profe” mía, además, debo decir, profesora titular de la Universidad de Chile, en el Instituto de Nutrición y Tecnología de Alimentos. Es experta en estudios de envejecimiento a nivel nacional y latinoamericano.

Orazio Attanasio, doctor en Economía de la London School of Economics, profesor del Departamento de Economía de la University College London. Ha desarrollado investigaciones sobre ciclo de vida y evaluación de políticas públicas en países en desarrollo, y ha estudiado detalladamente el impacto de la reforma previsional en Chile, del 2008.

Nicholas Barr, doctor en Economía de la Universidad de California, profesor de la London School of Economics. Es un reconocido experto en los sistemas de pensiones de varios países del mundo, incluido Chile.

Fabio Bertranou Jalif, doctor en Economía de la Universidad de Pittsburgh, especialista en mercado del trabajo, protección social y seguridad social, es oficial de la OIT en Argentina y especialista de



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mercado laboral y protección social de esta organización, y fue especialista principal de seguridad social de la OIT en Chile.

Hugo Cifuentes Lillo, doctor en Derecho de la Universidad Complutense de Madrid. Es profesor de Derecho de la Seguridad Social en la Pontificia Universidad Católica de Chile y de la Universidad Diego Portales. Es presidente de la Comisión de Usuarios del Sistema de Pensiones y delegado de la Organización Iberoamericana de la Seguridad Social.

Regina Clark Medina, abogada de la Universidad de Chile, con especialización en derecho del trabajo y seguridad social. Es profesora de Derecho del Trabajo e integrante del Centro de Relaciones Laborales de la Universidad Central, y fue parte del Comité Asesor Presidencial para la Reforma Previsional el 2006.

Martín Costabal Llona, ingeniero comercial de la Pontificia Universidad Católica de Chile y MBA de la Universidad de Chicago. Es director de empresas y miembro del Consejo Asesor Financiero del ministro de Hacienda. Fue miembro del Consejo Asesor Presidencial para la Reforma Previsional el año 2006.

Carlos Díaz Vergara, ingeniero comercial de la Universidad Católica y master en Economía de la Universidad de California. Es presidente del Consejo Consultivo Previsional y especialista en economía de las pensiones.

Christian Larraín Pizarro, ingeniero comercial de la Universidad de Chile y magíster en Economía de la Universidad Católica de Lovaina. Fue director del Sistema de Empresas Públicas y es especialista en reforma financiera, mercado de capitales, supervisión y regulación bancaria y financiera.

Igal Magendzo Weinberger, doctor en Economía de la Universidad de California, fue gerente de Análisis Macroeconómico del Banco Central y asesor Macroeconómico del ministro de Hacienda, desde



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donde participó en el Comité de Inversiones de la Superintendencia de Pensiones.

Mario Marcel Cullell, economista, ingeniero comercial de la Universidad de Chile y master en Economía de la Universidad de Cambridge. Es subdirector de Gobernabilidad y Desarrollo Territorial de la OCDE. Así que me imagino que está en París, Mario, en este momento, pero va a participar activamente. Fue presidente del Consejo Asesor Presidencial para la Reforma Previsional el 2006.

Costas Meghir, economista, doctor por la Universidad de Manchester. Es profesor del Departamento de Economía de la Universidad de Yale, y sus áreas de investigación incluyen políticas públicas, economía del trabajo, retiro y pensiones. Ha realizado un estudio detallado del impacto de la reforma previsional de Chile del 2008.

Carmelo Mesa-Lago, es profesor Emérito de Economía y Estudios Latinoamericanos en la Universidad de Pittsburgh. Es especialista en Economía de la Seguridad Social en América Latina y miembro de la Academia Nacional de Seguro Social.

Olivia Mitchell, economista, doctorada en la Universidad de Wisconsin-Madison. Fue miembro de la Comisión Presidencial en Estados Unidos para fortalecer la seguridad social. Es directora ejecutiva del Pension Research Council y directora del Boettner Center on Pensions and Retirement Research, de la Universidad de Pennsylvania.

Verónica Montecinos, socióloga, doctora en Sociología de la Universidad de Pittsburgh, muchas gracias por acompañarnos, ella viene desde Estados Unidos, profesora de Sociología en la Universidad de Pennsylvania e investigadora de igualdad de género, democracia y políticas públicas.

Leokadia Oreziak, economista, profesora de la Universidad París 1 y académica en la Escuela de Economía de Varsovia. Especialista en



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los campos de finanzas internacionales y los mercados financieros. Participó en la reforma previsional polaca del año 2011.

Joakim Palme, profesor de Ciencias Políticas en el Departamento de Gobierno de la Universidad de Uppsala, en Suecia. Presidió la comisión nombrada por el Gobierno de Suecia, dedicada a la tarea de elaborar un balance general para el desarrollo del bienestar social, que reformó las pensiones en su país.

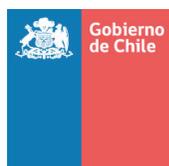
Ricardo Paredes, economista, ingeniero comercial de la Universidad de Chile y doctor en Economía de la Universidad de California. Es miembro del Consejo Consultivo Previsional y profesor de la Escuela de Ingeniería de la Universidad Católica de Chile.

Marcela Ríos. ¿Está la Marcela? Ah, está en Londres. Doctora en Ciencia Política de la Universidad de Wisconsin-Madison. Es docente del Doctorado en Ciencias Sociales de la Universidad de Chile, oficial responsable del área Gobernabilidad Democrática del PNUD en Chile y consejera y directora de Comunidad Mujer.

Claudia Robles, socióloga de la Pontificia Universidad Católica de Chile y doctora en Sociología de la Universidad de Essex, Inglaterra. Es especialista en políticas sociales y consultora de diversos organismos internacionales. Cuenta con variadas publicaciones sobre protección social y reducción de la pobreza en América Latina.

Claudia Sanhueza, economista de la Universidad de Chile y doctora en Economía de la Universidad de Cambridge. Es profesora en el Instituto de Políticas Públicas de la Universidad Diego Portales y especialista en Economía Laboral, Educación y Políticas Sociales. Fue integrante del Consejo Asesor Presidencial para el Trabajo y la Equidad, el año 2007 y 2008.

Jorge Tarziján, es economista de la Universidad Católica de Chile y doctor en Management por la Northwestern University. Ha sido consultor de diversos organismos internacionales en temas



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relacionados con sistemas de pensiones y desarrollo de mercados financieros.

Sergio Urzúa, economista de la Universidad de Chile y doctor en Economía de la Universidad de Chicago. Es profesor en el Departamento de Economía de la Universidad de Maryland y de la Pontificia Universidad Católica de Chile. Fue miembro de la Comisión Presidencial para el diseño del Ingreso Ético Familiar, del año 2010.

Andras Uthoff Botka, ingeniero comercial de la Universidad de Chile, doctor en Economía de la Universidad de California. Es profesor de la Universidad de Chile, fue miembro del Consejo Asesor Presidencial para la Reforma Previsional el 2006 e integra el Consejo Consultivo Previsional de Chile.

Como ustedes ven, tenemos una Comisión técnica de excepción, pero también queremos escuchar la voz de todos los actores sociales. Esta Comisión va a dialogar con representantes del mundo laboral y empresarial, Administradoras de Fondos de Pensiones, compañías de seguros, organismos internacionales, asociaciones de pensionados y expertos en la materia. Porque nosotros creemos que este debate no es sólo un tema de expertos, este debate nos incumbe a todos. Y queremos que la discusión sea amplia, sea transparente y sin temas vetados.

Sé que en este trabajo podremos articular puntos de vista, comprendiendo que el interés último es el bien de Chile y su gente.

Ellos tienen dos hitos. El primero, en octubre del 2014 me tienen que presentar el estado de avance, y las propuestas y el informe final tendrá que ser entregado en enero del 2015.

Por lo tanto, en enero del 2015 vamos a contar con un diagnóstico riguroso y, sobre todo, espero yo, con propuestas concretas para resolver las deficiencias de nuestro sistema previsional.



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Amigas y amigos:

Hacemos cargo de las necesidades de nuestro sistema previsional es apostar por una patria donde las personas no teman a la desprotección. Es dar tranquilidad a quienes han contribuido por años a nuestro desarrollo como sociedad y como país, y es reivindicar la idea de que nadie que trabaje, puede tener una pensión que lo empobrezca, en una patria justa. Y es demostrar que la grandeza de un país no sólo está en las grandes cifras, sino, ante todo, en el bienestar de cada uno de quienes habitamos este país.

Muchas gracias.

\* \* \* \* \*

Santiago, 29 de Abril de 2014.  
MIs.

## Appendix 2:

### Decree: Creation of the Advisory Commission on the Pension System.



Ministerio de Hacienda  
Subsecretaría de Hacienda

**MINISTERIO DE HACIENDA**  
**OFICINA DE PARTES**  
**E3764/2014**  
**RECIBO**

**CONTRALORIA GENERAL**  
**TOMA DE RAZON**  
**RECEPCION**

DEPART. JURIDICO	
DEPT. T.R. Y REGISTRO	
DEPART. CONTABILIDAD	
SUB. DEP. C. CENTRAL	
SUB. DEP. E. CUENTAS	
SUB. DEP. C.P.Y BIENES NAC.	
DEPART. AUDITORIA	
DEPART. V.O.P.U Y T.	
SUB. DEP. MUNICIPAL	

**REFRENDACION**  
REF. POR \$ \_\_\_\_\_  
IMPUTAC. \_\_\_\_\_  
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**CREA COMISION ASESORA PRESIDENCIAL  
SOBRE EL SISTEMA DE PENSIONES**

N° 718

SANTIAGO, 29 ABRIL 2014

**VISTOS:** Lo dispuesto en los artículos 1° inciso cuarto, 19 N° 18, 24, 32 N° 6 y 35 de la Constitución Política de la República de Chile, los artículos 1° y 3° del D.F.L. N° 1/19.653 de 2001, del Ministerio Secretaría General de la Presidencia, que fija el texto refundido, coordinado y sistematizado la Ley N° 18.575, Orgánica Constitucional de Bases Generales de la Administración del Estado, el Decreto Ley N° 3.500, de 1980, del Ministerio del Trabajo y Previsión Social que establece un Nuevo Sistema de Pensiones y en la Resolución N° 1.600, de 2008, de la Contraloría General de la República, y

**CONSIDERANDO:**

1. Que, por medio de la dictación del decreto ley N° 3.500, de 1980, se instauró en nuestro país un Sistema de Pensiones que significó una profunda transformación del sistema previsional chileno, pasando de un régimen público de reparto a uno de capitalización individual, con administradores privados y regulación del Estado.
2. Que, habiendo transcurrido veinticinco años desde la instalación del sistema, en 2006 se convocó al Consejo Asesor Presidencial para la Reforma Previsional a fin de que realizara una evaluación informada acerca de los logros y carencias del sistema previsional chileno,
3. Que, la misión de dicho Consejo fue elaborar recomendaciones que sirvieran de base para el diseño de un sistema de pensiones que entregare protección social efectiva a toda la población, incluyendo medidas para aumentar la densidad de cotización de los afiliados, aumentar la incorporación de los trabajadores independientes al sistema previsional, eliminar discriminaciones contra las mujeres y los trabajadores de menores ingresos, y elevar el rendimiento de las cotizaciones efectuadas por los trabajadores,
4. Que, los resultados del trabajo de dicho Consejo, junto con la labor del Comité de Ministros para la Reforma Previsional, constituyeron una sólida estructura para la elaboración del Proyecto de Ley de Reforma Previsional que fue enviado al Congreso Nacional en el mes de diciembre de 2006,

5. Que, dicho proyecto de ley fue aprobado, convirtiéndose en la ley N° 20.255 que establece la Reforma Previsional, la cual fue publicada el día 17 de marzo de 2008.
6. Que, la Reforma Previsional introdujo diversas modificaciones al Sistema de Pensiones, tales como la creación del Sistema de Pensiones Solidarias; el bono por hijo en el caso de las mujeres; la incorporación gradual de los trabajadores independientes; modificaciones al sistema de inversiones; la licitación de cartera de nuevos afiliados y del seguro de invalidez y sobrevivencia; modificaciones al funcionamiento de los gobiernos corporativos de las Administradoras de Fondos de Pensiones (en adelante AFPs); el fortalecimiento del Ahorro Previsional Voluntario; y el fortalecimiento de la institucionalidad pública ligada al funcionamiento del Sistema de Pensiones.
7. Que, la precitada reforma supuso importantes avances, en especial la erradicación de la indigencia y la reducción la pobreza de nuestros adultos mayores.
8. Que, no obstante lo anterior hoy en día existe consenso de que el actual Sistema de Pensiones debe ser revisado, de modo de asegurar que todas las personas puedan gozar de una vejez digna y de una adecuada protección frente a la invalidez y en el caso de sobrevivencia; y
9. Que, es un compromiso de este Gobierno revisar el actual Sistema de Pensiones a fin de realizar un diagnóstico acerca de su funcionamiento y elaborar alternativas de solución frente a las deficiencias que se encuentren, con especial énfasis en mejorar la cobertura -afiliación y densidad de cotizaciones-, la calidad de las pensiones, la equidad de género y las condiciones de ahorro en el sistema contributivo.

#### DECRETO:

**ARTÍCULO PRIMERO.** Créase una Comisión Asesora Presidencial sobre el Sistema de Pensiones, en adelante, "la Comisión", que tendrá por objeto estudiar el Sistema de Pensiones establecido en el decreto ley N° 3.500 de 1980 y en la ley N° 20.255 de Reforma Previsional de 2008, realizar un diagnóstico acerca del actual funcionamiento de estos cuerpos normativos y elaborar propuestas destinadas a resolver las deficiencias que se identifiquen.

**ARTÍCULO SEGUNDO.** Para el cumplimiento de su cometido, corresponderá a la Comisión especialmente las siguientes tareas.

- a) Realizar un estudio y análisis de los resultados observados y proyectados del Sistema de Pensiones, tomando en consideración las necesidades de la población.
- b) Elaborar un diagnóstico acerca de los atributos, limitaciones, deficiencias y desafíos del Sistema de Pensiones.
- c) Elaborar propuestas orientadas a resolver las principales deficiencias del Sistema de Pensiones, identificando, asimismo, otras medidas complementarias que resulten necesarias.
- d) Requerir de los ministerios, servicios y organismos públicos toda la información que considere necesaria para cumplir el mandato encomendado.
- e) Solicitar a los organismos competentes la realización de estudios que permitan conocer la opinión de la ciudadanía en materias relativas a la previsión social.

- f) Realizar audiencias con organizaciones de la sociedad civil, representantes del mundo laboral y empresarial, Administradoras de Fondos de Pensiones, Compañías de Seguros, expertos y académicos nacionales e internacionales en la materia.
- g) Efectuar seminarios, en los que serán convocados connotados expertos internacionales, a fin de conocer las principales tendencias a nivel comparado en materia de sistema de pensiones, aprovechando dicha instancia para resolver interrogantes sobre aspectos específicos de la realidad previsional chilena; y
- h) Realizar las demás tareas que sean necesarias y pertinentes para el cumplimiento de su cometido de asesoría a la Presidenta de la República.

**ARTÍCULO TERCERO:** La Comisión deberá velar porque las propuestas que formule sean relevantes, concretas, eficaces, eficientes y viables, y por la coherencia interna de todas ellas, precisando la gradualidad para su implementación. Asimismo, deberá velar porque ellas cuenten con viabilidad financiera, política e institucional.

**ARTÍCULO CUARTO:** La Comisión deberá entregar a la Presidenta de la República un informe de estado de avance, durante el mes de octubre de 2014, que resuma los testimonios de los participantes de las audiencias realizadas y contenga el diagnóstico sobre el funcionamiento del Sistema de Pensiones, identificando sus principales deficiencias.

Asimismo, deberá elaborar un informe final que contenga las propuestas de solución a las deficiencias identificadas en el diagnóstico, el que será entregado a la Presidenta de la República en el mes de enero de 2015. Con la entrega de dicho informe finaliza el funcionamiento de la Comisión.

**ARTÍCULO QUINTO -** La Comisión estará integrada por las siguientes personas:

1. David Bravo Urrutia, quien ejercerá como Presidente de la Comisión
2. Cecilia Albala Brevis
3. Orazio Attanasio
4. Nicholas Barr
5. Fabio Bertranou Jalif
6. Hugo Cifuentes Lillo
7. Regina Clark Medina
8. Martín Costabal Liona
9. Carlos Díaz Vergara
10. Christian Larrain Pizarro
11. Igal Magendzo Weinberger
12. Mario Marcel Cullell
13. Konstantinos Meghir
14. Carmelo Mesa-Lago
15. Olivia Mitchell
16. Verónica Montecinos Mac-Adoo
17. Leokadia Oreziak
18. Joaquim Palme
19. Ricardo Paredes Molina
20. Marcela Ríos Tobar
21. Claudia Robles Fariás
22. Claudia Sanhueza Riveros
23. Jorge Tarzijan Martabit
24. Sergio Urzúa Soza
25. Andras Uthoff Botka

Las personas antes designadas no podrán ser reemplazadas en caso de ausencia o impedimento en el ejercicio de sus funciones, salvo expresa designación por medio de la dictación del Decreto Supremo respectivo.

Cada uno de ellos, sin perjuicio de su pertenencia o vínculo actual o pasado a alguna institución pública o privada, no integrará la Comisión en calidad de representante de ninguna de ellas.

Sin perjuicio de lo anterior, la Comisión podrá solicitar la participación de funcionarios de la Administración del Estado, así como de personalidades de reconocida competencia en los ámbitos político, social, científico o académico, expertos o personas, nacionales o extranjeras, vinculados a temas de previsión social.

**ARTÍCULO SEXTO:** El Presidente de la Comisión, además de las funciones que le corresponden como miembro integrante de aquella, estará a cargo de su conducción y contará con las atribuciones necesarias para su adecuado funcionamiento interno.

La Comisión Asesora contará con una Secretaría Ejecutiva, que servirá de instancia de comunicación y coordinación con los organismos públicos y privados relacionados con la materia y será responsable del cumplimiento de la agenda de trabajo de la Comisión, así como del registro y sistematización de sus audiencias y deliberaciones. Una Secretaría Técnica que, por otra parte, generará y mantendrá el material bibliográfico que requiera la Comisión Asesora, coordinará la ejecución de los estudios que la Comisión encargue para el desempeño de su labor y realizará las labores encomendadas por el Presidente de la Comisión.

Corresponderá al Presidente de la Comisión Asesora Presidencial designar al Secretario Ejecutivo, al Secretario Técnico y al personal técnico de apoyo, de conformidad a lo dispuesto en el artículo siguiente.

**ARTÍCULO SÉPTIMO:** El Ministerio de Hacienda y de Trabajo y Previsión Social, prestarán el apoyo técnico que sea necesario para el funcionamiento de la Comisión. Con todo, los actos administrativos que se requieran para el adecuado funcionamiento de la Comisión serán emitidos a través del Ministerio del Trabajo y Previsión Social.

**ARTÍCULO OCTAVO:** Las autoridades y directivos de los órganos de la Administración del Estado prestarán a la Comisión, dentro del ámbito de sus respectivas competencias, toda la colaboración e información que este les solicite.

**ARTÍCULO NOVENO:** La Comisión fijará, en su sesión constitutiva, las demás normas necesarias para su funcionamiento. Los integrantes de la Comisión desempeñarán sus funciones ad honorem.

ANÓTESE, TÓMESE RAZÓN, COMUNÍQUESE Y  
PUBLÍQUESE.



**MICHELLE BACHELET JERIA**  
Presidenta de la República



REPUBLICA DE CHILE  
MINISTRO  
MINISTERIO DE HACIENDA  
**ALBERTO ARENAS DE MESA**  
Ministro de Hacienda



**JAVIERA BLANCO SUAREZ**  
Ministra del Trabajo y Previsión Social

### Appendix 3: Description of some of the elements which make up the Chilean pension system

**The Return Fluctuation Reserve Fund** was made up of affiliate resources that were used to cover risks and to absorb possible negative returns of the pension funds.

**Reserve** is the money, equal to 1% of the accumulated funds in an AFP, which has to be kept in reserve to contribute to the affiliates' accounts in the case of returns fall below than the minimum requirement. With the modifications of these two factors, the elimination of the Return Fluctuation Reserve Fund and the decrease of the Reserve, the risk of losses has been transferred from the AFPs to the affiliates.

**The Multifund system** (created by Act 19.795 on February 28, 2002) refers to the administration of 5 Pension Funds by each AFP, which differ from each other in the ratio of their portfolio invested in equity securities, which implies different levels of risk and profit. Fund A has a larger share of investment in variable returns, which progressively diminishes in each of the subsequent funds.

**SCOMP** is an electronic consultation system for pension amounts. It is a system which allows future pensioners to request offers for pension amounts, in order to facilitate an informed and transparent decision.

**The grant per child** is a benefit that increases women's pension amounts by awarding a bonus for each child born alive or adopted. It is a state contribution, equal to 10% of 18 months of minimum wage as determined for workers between 18 and 65 years old. The grant is applied during the month of the child's birth.

**Collective Voluntary Welfare Saving** is a mechanism for saving which a company can offer. With this mechanism, workers' savings are complemented by contributions from their employers.

**Social security subsidy for young workers** is a state run benefit, corresponding to a welfare subsidy targeted at young workers and their employers, equal to 50% of the mandatory welfare contribution (10% of taxable income with a maximum limit of 72.3 UF), calculated over the minimum monthly income. Both the worker and the

employer receive equal amounts of the benefit; in the case of the worker, this benefit is directly transferred into their individual capitalization account.

**The Welfare Education Fund** was created with the aim of supporting the funding of projects, programs, activities and measures for the promotion, education and dissemination of the pension system.

**Compensation in the case of divorce** consists in the transfer of funds, once the judge determines that there has been economic damage towards one of the spouses, from the individual capitalization account of the spouse that must compensate to that of the spouse who must be compensated. The AFP has to transfer the funds as ordered by the judge.

**The User Commission of the Pension System** serves to inform the Undersecretary of Social Security and other public organisms from the sector about the evaluations their representatives carry out assessing the operations of the pension system, while proposing education and dissemination strategies. The Commission includes a representative of the workers, of the pensioners, of public institutions and of the private entities of the pension system, as well as an academic who presides as the president.

**The Advisory Council on Social Security** serves to advise the Labor and Social Security Ministry as well as the Treasury Ministry about matters related to the Solidary Pension System.

**The Technical Council of Investments** was created with the aim of formulating reports, proposals and pronouncements regarding the investment of Pension Funds, in order to achieve adequate returns and financial security. The Council is made up of a member designated by the President of the Republic, a member designated by the Council from the Central Bank of Chile, a member designated by the Pension Fund Administrators and two members designated by the Economy and Business Administration Departments of the Universities with accreditation according to Law No. 20.129.

**The taxable limit:** according to Article 16 of the Decree 3.500 from 1980, the taxable limit refers to the limit established by the maximum income subject to social security contributions. Until the 2008 reform, the taxable limit for the mandatory pension account remained unchanged, in a context in which real income had grown and an annual average rate of 2.4% for the 10 years prior to the reform. Since the 2008 reform, this limit has been adjusted annually according to the variation of the Real Income Index (IRR), published by the National Institute for Statistics. Today the limit has grown by 17%, reaching 72.3 UF.

**Minimum return required:** Each month, the administrators are responsible for ensuring that the annual real return of the last 36 months of each of their funds does not fall below whichever standard is lower: a) the annual real return of the last 36 months' average of all the funds of the same type, minus four (two) percentage points, or b) the annual real return of the last 36 months' average of all the funds of the same type, minus the absolute value of 50% of that return.

### Abbreviations

<b>Basic Solidarity Pension</b>	PBS
<b>Top Up Welfare Complement</b>	APS
<b>Solidarity old-age Welfare Complement</b>	APSV
<b>Maximum Pension with Solidarity Complement</b>	PMAS
<b>Pension Fund Administrators</b>	AFP
<b>Assistance Pension</b>	PASIS
<b>Social Security Institution</b>	IPS
<b>Budget Directorate</b>	DIPRES

## Appendix 4: Global Proposals for Reform Analyzed by the Commission

### 1. GLOBAL PROPOSAL A: Improving benefits, adequacy, coverage and equity in Chile's pension system

#### I. THE STRATEGY

1. President Michelle Bachelet entrusted the Commission with identifying the deficiencies of the current pension system and developing proposals to address them. She also requested that the proposals should be coherent and financially, politically and institutionally feasible.

2. Proposal A accomplishes these ends through a series of mutually reinforcing policies, in ways that:

- (a) Increase pensions immediately for the already-retired and soon-to-be retired;
- (b) Enhance the prospects of future workers and pensioners; and
- (c) Maintain essential incentives for saving, investment, and economic growth.

3. Specifically, the Proposal fulfils the Presidential mandate along a range of dimensions:

- » It addresses the issue of the legitimacy of the system:
  - By strengthening the solidarity pension – the Pay As You Go (PAYG) element – by significantly increasing benefits and extending coverage to more people; and
  - By accommodating options for radical reform of the saving element.
- » It increases low pensions and increases replacement rates; and by doing so through the solidarity pension it reduces the dispersion of replacement rates. These elements particularly benefit women.
- » It introduces a new employer contribution to the Solidarity Fund.
  - Though the combination of tax finance and the employer contribution, the Proposal incorporates both intergenerational transfers and solidarity within the system through re-

distribution from higher- to lower-income people.

- The Proposal is fiscally responsible. It creates a system that will stand the test of time – a system that pays higher benefits to today's pensioners and can keep its promises to future pensioners.

#### 4. CHILE'S 2008 REFORM WAS FUNDAMENTALLY IMPORTANT.

Until 2008, the Chilean pension system was based mainly on individual savings through AFP accounts. That design provided consumption smoothing for those with complete (or nearly complete) contribution records but did not provide poverty relief for pensioners with low lifetime earnings, nor provide adequate benefits for those with incomplete contribution histories.

5. In other words, Chile did not have a pension system, but only part of a system. The 2008 reforms were fundamentally important because they rounded and completed the system by creating the structure of solidarity benefits.

6. The 2008 strategy has two key elements:

- A PAYG element – the tax-financed Solidarity Pension System – provides poverty relief for people with little or no other retirement income, and offers some insurance against poor labor market outcomes by topping up benefits for those with incomplete covered earnings histories.
- A saving element – the AFP system – mainly provides consumption smoothing for those with complete or near-complete contribution records, plus some smoothing for those with incomplete coverage.

7. The strategy is sound because it addresses the three core objectives of poverty relief, old-age income insurance, and consumption smoothing. The 2008 reform was also a major advance because the component parts of the system were integrated.

**8. BUT THE 2008 REFORM LEFT UNFINISHED BUSINESS.** The Commission's diagnosis identified important remaining challenges:

- Low pensions: though the system generated sufficient pensions for some, it provided low pensions for many.
- Low coverage: many people do not contribute all the time, nor do they pay the full amount owed to their account; and many self-employed workers are still not participating.
- Charges by AFPs continue to be a problem, despite the improvement brought about by the auction mechanism introduced under the 2008 reform, because many people do not move to AFPs with lower charges.
- Gender inequality in benefits continues to be a problem.
- Lack of trust in the pension system is serious.
- Levels of financial literacy remain low.

**9. FINANCING BENEFITS FROM THE SAVINGS ELEMENT IS NOT THE ANSWER.** One suggested approach is to divert AFP contributions and perhaps also assets to finance higher pensions today. Proposal A rejects that approach because it solves problems today at the expense of workers and pensioners in the future. Diverting contributions to finance current benefits reduces saving. That matters greatly because inadequate saving (a concern of governments in many countries) is even more of a concern in Chile, where there will be fewer workers in the future because of declining fertility, and more pensioners because of rising life expectancy.

10. Maintaining consumption by pensioners during longer periods of retirement must rely on growing output. But a decline in Chile's workforce will reduce the growth of output unless offset by other factors. If the workforce declines, the appropriate response includes policies to make each worker more productive, now and in the future. To do so requires substantial investment in human capital – more education and training – and physical

capital – more and better plant and equipment.

11. Thus policies that reduce saving are mistaken in the context of Chile for two reasons:

- They undermine investment and thus harm the prospects of future workers and pensioners.
- They unintentionally make promises that cannot be kept. Chile should not repeat the mistakes of the 1981 reform, which created expectations that could not be met.

12. Any policy that would reduce saving, by exerting downward pressure on investment, is entirely the wrong way to go. **The distinctive feature of the strategy in Proposal A is that it finances broadly the same increase in benefits as other Proposals but finances the increase through government spending and a new employer contribution. By reducing saving less, Proposal A improves the prospects for future living standards and hence the ability to pay promised pensions in the future.**

**13. STRENGTHENING PAYG AND IMPROVING THE SAVINGS ELEMENT.** For these reasons, the best way forward is to build on the 2008 strategy by boosting the solidarity element and improving the saving element.

14. Proposal A improves adequacy, coverage and equity in Chile's pension system. Specifically, the proposal:

» Strengthens solidarity benefits by:

- Making the solidarity pension universal and increasing the level of benefit for poor and middle-income people. Thus the proposal broadens the solidarity pension from mainly poverty relief to one that also incorporates insurance and consumption smoothing.
- Financing increased benefits in part through a new employer contribution to the Solidarity Fund.

- » Introduces major reforms to the saving component by:
  - Financing increased benefits in part through a new employer contribution to AFP accounts.
  - Introducing a new government-run AFP, with strict rules of governance, to boost trust in the system.
  - Taking further action to reduce charges in the AFP system.
- » Improves gender equity and benefits for low-wage workers:
  - Raising the solidarity pension: since women typically have lower contribution densities, a larger non-contributory element particularly benefits women;
  - Sharing partners' pension contributions on a year-by-year basis.
  - Over time, equalizing retirement ages between men and women and mandating the use of unisex life tables.
  - Commissioning an actuarial commission to relate retirement ages to life expectancy.

## II. KEY ELEMENTS OF PROPOSAL A

### II.1. Changes to the solidarity noncontributory pillar

15. Benefits. Proposal A strengthens the solidarity pension system, boosting poverty relief and raising replacement rates. The major beneficiaries are workers with low earnings and/or incomplete contributions records – disproportionately women.
- i. The Proposal merges the Pension Basica Solidaria and Aporte Previsional Solidario into a single universal benefit, the University Solidarity Pension, covering at least 80% of the retired population, with an affluence test to screen out the best off.
  - ii. It increases the Universal Solidarity Pension for a person with no AFP pension by 20% relative to the PBS for those with no AFP contributions.
  - iii. It increases the Universal Solidarity Pension by (say) \$200 for each \$1000 of AFP pension per month up to (say) the 50th percentile of income. This element boosts pensions in the middle income ranges by including an element of match, and thus strengthens incentives to formality.
  - iv. It tapers the solidarity benefit for those receiving AFP pension benefits above (say) the 50th percentile of AFP pension income, reaching zero at the 90th percentile of AFP pension income.
  - v. It provides actuarially fair incentives for those who postpone the start of their retirement benefit.
16. Finance. Proposal A provides new sources of revenue for the solidarity pillar without damaging saving, thus creating a system designed to stand the test of time, i.e. one that can pay higher benefits both today and to future pensioners. The new sources are:
- i. General revenues of 0.2% of GDP from taxes immediately and into the foreseeable future; this is equal to 1.2% of the current national budget.
  - ii. A new employer contribution of 2% of earnings up to the contribution ceiling.
  - iii. The definition of covered earnings is to be expanded by including remuneration now excluded from contributions. Also the covered earnings ceiling will be increased, see below.
17. Timing. Benefit and tax increases to take place over the next 5 years.
18. Impact on elderly poverty. The original PBS targeted the poorest 60% of households and reduced poverty by 2 percentage points in the age 65+ age group. Making the solidarity benefit universal, as recommended by the Commission, would reduce elderly poverty further.

## II.2. Changes to the AFP pillar

19. Sections 2.2. and 2.3 describe changes that improve the operation of the saving element. As discussed in section 2.7, the strategy is compatible also with more radical reform of the saving element, including plans that allow wider risk sharing. The immediate changes are to:
20. Continue workers' contribution rates at 10% of covered earnings, but expand the definition of covered earnings to include remuneration now excluded.
21. Include a new 2% AFP matching contribution from employers, based on the broader definition of covered earnings.
22. Raise the contribution ceiling on covered earnings and index it to wages.

## II.3. Changes to the AFP marketplace

23. Set up a state-run AFP operated under the same rules as other AFPs, with an institutional setup that guarantees that it is completely self-employed of the state and is self-financing. It is essential that the AFP is self-employed and seen to be self-employed (for example with an independently chosen Board of Trustees) to increase trust in the system.
24. Periodically, participants would be automatically re-enrolled in the age-appropriate default fund of their AFP, determined by auction to have the lowest charges.
25. AFP costs and barriers to entry could be eased by decreasing the AFP reserve rate from 1% to 0.5% of total AFP assets.
26. Modify multi-funds to reduce risk, and reduce the number to 3 instead of 5. One of these should be a simple option with passive fund management, analogous to the US Thrift Savings Plan.
27. Hold periodic auctions for affiliates of AFP licenses, with all licenses at stake.
28. The programmed pension should be eliminated, with annuitization compulsory, except for very small accumulations. Annuitization should be based on unisex life tables. Further

discussion is needed about how the system would work, in particular (a) whether or not the mandate should apply to a person's entire accumulation and (b) the role of joint-life annuities<sup>107</sup>.

## II.4. Changes in retirement ages

29. This element addresses an important element of sustainability, consonant with trends in other OECD countries.
30. Move men and women to the same minimum pension age, initially age 65 for AFP and solidarity pensions.
31. An independent actuarial commission should index the minimum pension age to changes in life expectancy in the future.

## II.5. Changes to improve gender equity

32. Section 2.5 explicitly addresses gender – a central element in the Presidential mandate.
33. Unisex mortality tables should be used for annuitization
34. The pension contributions of husband and wife and other formal partnerships should be shared on a year-by-year basis, with 50% of the husband's contributions going into his wife's accumulation and vice versa.
35. Add a tax-financed contribution to the AFP account for people caring for young children and the elderly<sup>108</sup> for each year of caregiving activity.

## II.6. Other elements

36. Improve contribution densities through better enforcement via a special unit in the Ministerio de Trabajo charged with this task.
37. Reduce disincentives associated with social programs leading to lower contributions and densities.

<sup>107</sup> Year-by-year sharing of pension contributions (section 2.5) reduces the strength of the argument for making joint-life annuities mandatory.

<sup>108</sup> One Commissioner dissents from the idea of contributing in respect of care of the elderly.

38. Promote financial education and literacy programs, to be started as pilots and evaluated (for example, by randomized trials) to gauge their effectiveness.

### **II.7. Looking ahead**

39. The central elements of the strategy in Proposal A are:

- » To strengthen the solidarity pension system, a desirable objective in its own right;
- » To increase gender equality, also desirable in its own right; and
- » To maintain the saving element, to enable the system to keep its pension promises.

40. It is mistaken to think that the last element makes Proposal A a conservative strategy. Though maintaining saving is central, saving does not necessarily have to be organized via the AFP system, but can be arranged in many different ways. The strategy including, importantly, the introduction of a government-organized AFP, is compatible with multiple ways of organizing saving, including, as a small sample:

- » The Thrift Savings Plan for US federal civil servants, a simple, cheaply-managed savings plan with centralized administration and a default option with passive fund management.
- » A pension financed from a sovereign wealth fund (Norway is the closest example).
- » Collective defined-contribution occupational pensions, as in the Netherlands.

Thus Proposal A is designed to accommodate radical reform.

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## 2. GLOBAL PROPOSAL B

### Presentation

This is a proposal to improve the current pension system by putting forward a new social contract for senior citizens that incorporates more solidarity and reduces the system's emphasis on the individual. The proposal is based on the principles of social security, and seeks to diversify and spread out the system's inherent risks, ensuring a threshold of protection for seniors and allowing the social security system to regain social legitimacy.

**This proposal seeks to improve both the system's coverage and the pension amounts of current and future retirees and to preserve financial stability. The proposal addresses all aspects of the Commission's mandate, including: (i) increasing the social legitimacy of the pension system; (ii) reducing the excessive financial exposure of affiliates; (iii) increasing the public's willingness to understand and accept the changes to the system's parameters that would make it financially viable; (iv) using intergenerational solidarity to diversify the risks that affect pensions; (v) creating incentives to stimulate contributions and increase contribution density; (vi) addressing the gender inequalities that are generated by the system's operation; (vii) facilitating the inclusion of self-employed workers. Although this proposal does not eliminate individual accounts, it does emphasize the need to make significant changes in the individual capitalization pillar.** Its implementation will be gradual and will not affect the rights of current affiliates. The balance of their individual accounts will not be negatively affected; on the contrary, current affiliates who, despite their contributory efforts, have balances that are considered insufficient according to the new social security system will see their pensions improve.

**This proposal seeks to transform the current system into a mixed and integrated system that combines a social security component (for all workers<sup>109</sup>) with a mechanism that complements**

109 In this presentation, we chose a threshold of \$350,000 in 2013. That figure corresponds to the salary that, with a replacement rate of 70 percent, would provide a pension that is equal to the minimum wage, which is considered a decent pension in many countries. It also represents the cut-off point that separates the funds collected in the current system into two halves.

**mandatory individual account capitalization. The system of individual accounts would be like the current system but with significant reforms (in the administration of the contributions for workers in the lower income brackets, for example). The social security component could be conceptualized as a form of collective capitalization with notional accounts that would link contributory efforts to an individual's pension amount. The proposal also includes a basic non-contributory benefit that would be similar to the current basic solidarity pension. The proposal, then, has three central pillars: a non-contributory basic universal pension + a social security component + individual accounts<sup>110</sup>. The introduction of a social security component is crucial to this proposal; it is the heart of the contributory component and all workers, irrespective of their income, participate by paying into it. The capitalization component, in contrast, becomes a mechanism for mandatory savings for workers whose income is higher than a specified threshold.**

### Strategy

Since the 2008 reform, the current pension system has done more to maintain consumption in retirement (through individual savings accounts) and to alleviate poverty in old age (through the solidarity pillar). The system is consistent with fiscal responsibility and contributes to financial savings that come to 2.6 points of the GDP (2013 figures). The system is funded by contributions from workers and by a state contribution that is equivalent to 0.7 % of GDP.

While the changes introduced in 2008 were important and represented progress in the area of social security, they were not enough to establish a system that delivers adequate pensions. The benefit that smooths consumption (by reducing disparities in consumption between an affiliate's active and passive stages), has limited coverage, and the non-contributory benefit covers only the poorest groups. The fees charged by the system remain high. The system lacks solidarity among affiliates, particularly with regards to gender,

110 Internationally, Costa Rica, Uruguay and Sweden all have systems with components that are similar to the elements of this proposal.

where it fails to reduce the enormous differences in the pensions between men and women. Affiliates continue to be responsible for making complex financial choices that can ultimately affect their pensions. Finally, the system lacks any contributory financing by the employer.

With regard to these shortcomings, Proposal A offers a series of specific measures and maintains the current solidarity and individual capitalization pillars. Although Proposal B modifies these pillars, both proposals coincide in several respects, as was made clear when the Commission voted on a number of specific proposals. For instance:

1. With respect to the solidarity pillar:
  - a. We agree on the need to expand the system's coverage and to increase the amount of the PBS.
  - b. Although we agree that the solidarity pillar should be redesigned, we have important differences with regards to how the pillar should be structured and funded.
2. With respect to the capitalization pillar:
  - a. We agree on the need to improve market competition (AFPs and Annuities) and also on the creation of a state AFP. But we suggest more effective action by creating a "Clearing House" (like what they have in Sweden).
  - b. We appreciate many of the proposals aimed at achieving greater gender equality and agree on the need to use unisex Mortality Tables.
  - c. We support proposals to reduce contribution evasion and labor avoidance.
  - d. We support the reduction of the multi-funds in order to limit both the decision-making required and the transfer of risk onto the affiliates.
  - e. We support efforts to incorporate self-employed workers that are consistent with a strategy of social protection.
  - f. We support initiatives include employer contributions.

Nevertheless, these measures are insufficient to solve the problems of the current system. Our approach is different. Along with considering the importance that the pension system has on savings and fiscal solvency, we are concerned with building a system that, by reducing inequality, is viewed as legitimate by Chilean citizens. To do this, we recommend strengthening the social security component according to international standards on social security systems. In this sense:

1. With regards to the poverty relief, Proposal B recommends extending the coverage of non-contributory pillar.
2. With regards to benefits that smooth consumption, Proposal B seeks to reconcile the logic of contracts for individual savings with the logic of solidarity that is needed to extend the coverage of such benefits. Solidarity is financed with contributions from the state and the employer.
3. Proposal B is designed so that contributing affiliates are not, upon retirement, faced with making a large number of complex financial decisions that can negatively affect their pensions. The proposal financially protects both the contributions based on incomes that are below \$350,000 and the solidarity contributions in the Pension Reserve Fund.
4. Proposal B re-introduces the contributory financing by the employer.
5. Proposal B re-establishes intergenerational solidarity to account for demographic changes.
6. Proposal B facilitates a better understanding of the system, allowing affiliates to better assess proposed changes.
7. The proposal considers a gradual transition, with full respect for the choices of affiliates. It only enhances their self-financed benefits with contributory and solidarity resources from the generation that is currently active.

Given this, the question arises: What goals can best be achieved with the proposed mixed system as compared to with adjustments to the logic of the current system?

- 1) For equivalent increases in pensions, this pro-

posal allows for the possibility of relying less on fiscal adjustments through taxes and /or public debt. This is an essential factor in the current context, where there is little-to-no room for establishing new tax reforms and where the delicate fiscal situation requires that public borrowing be handled with extreme prudence.

- 2) This proposal seeks to grant the pension system legitimacy in the eyes of the public, based on a new social contract centered on a real system of social security. The absence of legitimacy is a problem in and of itself, since it introduces a large element of uncertainty in the system's foundations. Confidence in the system's foundations is essential for the proper functioning of the system in the long term, and uncertainty can propel a vicious cycle that contributes to the further deterioration of most pensions.
- 3) The proposal seeks to improve the public's willingness to accept changes to the system's parameters. All pension systems (individual or PAYG) must periodically carry out parametric adjustments (to the contribution rate, the retirement age, the link between rights and obligations) to ensure sustainability.
- 4) The proposal better diversifies risk. A capitalization system bases its returns on the performance of financial assets. The solidarity component bases its returns on GDP growth. The combination of the two gives returns greater stability.
- 5) The proposal reduces the transfer of risk to workers. By introducing a solidarity component, the horizon of benefits becomes more predictable in the eyes of the workers.
- 6) The proposal reduces the costs of the system, benefiting workers. In its solidarity component, the system would have a centralized administration that would generate low operating costs because it would not require an administrative infrastructure of financial roles that is as costly as the current system.

It is important to note that Proposal B does not alter the acquired rights of affiliates regarding their savings in individual accounts, which will remain in their accounts in their current state, both for active contributors and for current pensioners.

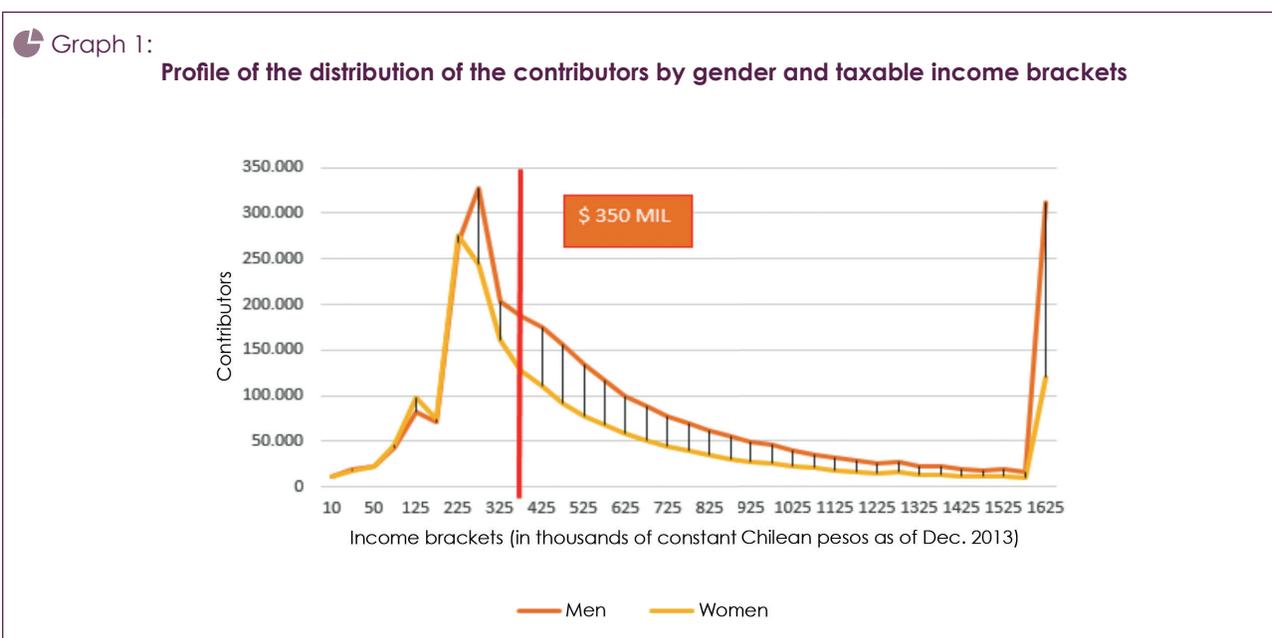
### **Proposal B:**

The current pension system requires a different mechanism for financing the benefit that seeks to smooth consumption (the contributory part of the original system). The current system of funding relies exclusively on individual savings contracts and prevents solidarity among contributing affiliates. That is to say that the system needs a new way to finance contributory pensions, which would amount to a new social contract.

### **Elements of the diagnostic**

Figure 1 illustrates the distribution of the affiliates that contribute in the current system by taxable income brackets.

In December of 2013 4,992,319 people contributed to the system. Of these 59.5% were men (2,972,093 people) and 40.5% were women (2,020,226 people). There is dramatic inequality between men and women in the pension system. Women participate less and contribute based on lower taxable incomes than men do. Of all men, only 35% contribute based on a taxable income that is less than \$ 350,000, while for women this percentage reached 53%.



Source: Superintendencia of Pensions

The contributions collected that month reached \$3.4 billion. Of these, 57 percent came from the contributions of men with incomes over \$350,000. In contrast, women earning less than \$350,000 contributed only 8% of this figure. Given that the logic of the current system privileges individual accounts, it is not surprising that the system today delivers good pensions to a few people but does not deliver them to the vast majority of people. In fact, the Commission's assessment of the system revealed that even after one takes into account the benefits from the solidarity pillar, 78% of women and 55% of men receive pensions that are below the poverty line and 82% of women and 69% men receive pensions below the minimum wage (70% of \$350,000).

What is collected from the affiliates in the current system represents approximately 2.6% of GDP. Affiliates pay fees to the AFPs for financial intermediation services, amounting to about 0.3 percent of GDP.

By privileging the allocation of affiliate contributions to the country's financial savings through a logic of individual savings accounts, the pension system leaves a large majority of people, particularly women and workers in vulnerable jobs, with insufficient old age pensions and with few guaranteed benefits.

**Table 1: Taxable income in the system by gender and taxable income brackets**

	Total		Earn less than \$350.000		Earn more than \$350.000			
	People	Income	People	Income	People	Income		
						Total	<\$350M	>\$350M
Men	2972093	64 %	1045023	7 %	1937070	57 %	20 %	37 %
Women	2020226	36 %	1073360	8 %	946866	28 %	11 %	17 %
Total	4992319	100 %	2118383	15 %	2873936	85 %	31 %	54 %

Source: Authors with information from the Superintendencia of Pensions

## Proposal B Details

Proposal B creates a contributory social security component with tripartite financing (with contributions from the worker, the employer and the State). This changes part of the contributory financing, the administration of pension funds and the benefits that the system grants. There will be three types of benefits granted by the system: non-contributory benefits (in the form of a basic pension), contributory benefits from the social security pillar and the traditional benefits that come from the capitalization component that is administered by the AFP.

### Social Security Pillar: Notional account registry<sup>111</sup> and Collective Savings Fund.

1. For contributory benefits, the proposal creates a Notional Accounts Registry System (SRNC) and for those with taxable incomes that are over \$350,000, the System of Individual Capitalization (SCI) will continue to be obligatory and will operate in a complimentary way.

2. The proposal is that all affiliates contribute 10% of the first \$350,000 of their taxable income to the SRNC. This collective savings account (or solidarity fund) is a different way of financing pensions. It is estimated that half of the financial savings flows currently allocated to individual accounts (equivalent to 1.3% of GDP) would go to the social security fund.
3. The proposal involves a model of matching funds. This means that for every dollar saved by affiliates, the pension system also provides a matching contribution. With these complementary resources, pension amounts will rise significantly.
4. The social security fund is financed by contributions of 10% from all contributors (up to a cap of \$350,000), a 3 or 4% increase in contributions from employers, and by a contribution of 7 or 6% from the state.

## Improve coverage-affiliation, density

### Promote affiliation at the moment of collection integrating both contributory sub-systems and generate an incentive to contribute (through matching funds).

1. From the affiliates with taxable incomes that are under \$350,000.
  - a) Contribute 10% into an account of the Notional Accounts Registry System (SRNC).
  - b) The estate and employers contribute an additional 10% (preferably 3 or 4% increase in contributions from employers, and by a contribution of 7 or 6% from the state).
2. From the affiliates with taxable incomes that are over \$350,000.
  - a) For the first \$350,000 of taxable income.
    - i. Contribute 10% into an account of the Notional Accounts Registry System (SRNC).
    - ii. The estate and employers contribute an additional 10% (preferably 3 or 4% increase in contributions from employers, and by a contribution of 7 or 6% from the state).
  - b) For the portion of the taxable income that is above \$350,000.
    - i. The worker's contribution will be allocated to the AFP they have selected (SCI).

SRNC

SCI

<sup>111</sup> A notional accounts system, like the current system in Sweden, requires a register of each individual's contributions, to which is added the returns that they receive in the system. This is the central component (but not the only component) that defines the benefits that individuals receive upon retirement.

1. The solidarity fund acts as a clearing house: it collects contributions, manages affiliate accounts, provides daily information services to affiliates and is responsible for providing new benefits to members. The solidarity fund will use both traditional and new collection mechanisms to facilitate collecting the contributions from self-employed workers. These functions could be assigned to the Institute of Social Security..
2.
  - a. The fund will collect the employer's contribution and the affiliate's contribution of 10% and each month it will allocate these contributions to the two contributory systems (social security and capitalization):
    - i. for the first \$350,000 of taxable income, the contributions from the worker and the matching contributions (from the state and employer) go to a system of notional accounts (the SRNC),
    - ii. for the portion of the taxable income that is above \$350,000, the worker's contribution will be allocated to the AFP they have selected (the SCI);
  - b. The contributions to the SRNC, along with the solidarity contributions from employers and the state, will feed into a collective account of social security that will be administered with the same criteria as the current Pension Reserve Fund of the Ministry of Finance.
  - c. Both contributory systems are based on individual accounts. The rate of return of the notional component is based on increasing the average salary covered and on an actuarial adjustment aimed at ensuring the financial sustainability of the system. The rate of return of the capitalization component is based on the rate of the relevant AFP fund.
2. If the value of the pension from the social security account in the notional registry is less than 75 percent of the minimum wage, the system will use the accumulated balance of the collective fund to double the amount until it reaches that threshold (75 percent of the minimum wage).
3. For current pensioners, a similar mechanism applies to increase the current pensions obtained from the AFP system.
4. The cap at 75 percent of the minimum wage applies to matching funds. The logic is that if one takes 75% of the minimum wage along with the current basic solidarity pension (which now represents 25 percent of the minimum wage), the affiliate will receive a pension that is equivalent to the minimum wage. The guarantee of a pension that is similar to the minimum wage will depend on the contributory behavior of each affiliate.

In short, this new solidarity pillar follows a logic of social security which could be conceptualized as a collective capitalization scheme with notional accounts financed by contributions from employers and assisted by tax revenue. This would replace the current Solidarity Pension Contribution (APS).

Table 2 shows an example of the allocation of the solidarity benefit that rewards contributory effort. These matching contributions are focused on creating solidarity and could be distributed differently than what we have in the example. The extent of matching contributions could, for example, differentiate between men and women at different levels of income.

### **Social Security Pillar: New modality for benefits (see example in Table 2)**

1. The Fund determines the pension that corresponds to the notional accounts and the AFP accounts based on the accumulated balances and life expectancy at retirement.
1. Column 2 of Table 2 represents the pension funded by the social security account in the form of an annuity based on the balance of the individual's notional account.
2. We can add this value to the PBS in column 3 of Table 2.
3. The matching from the solidarity contribution is calculated in columns 4 and 5 of Table 2.

**Table 2: Example of funds that match self-financed amounts for beneficiaries whose families belong to the poorest 80% of the population.**

			MATCHING FUNDS				
INCOME	SELF-FINANCED PENSION PRNC	PBS	RATIO	COMPLE- MENT	SUB- TOTAL	FINAL PENSION	REPLACE- MENT RATE 30 years
1	2	3	4	5	6 = 2+5	7 = 3+6	8 = 7/1
	0	100.000			0	100.000	
22.706	10.000	100.000	1*1	10.000	20.000	120.000	5,28
45.412	20.000	100.000	1*1	20.000	40.000	140.000	3,08
113.531	50.000	100.000	1*1	50.000	100.000	200.000	1,76
181.649	80.000	100.000	1*1	80.000	160.000	260.000	1,43
249.767	110.000	100.000	1*(0.75 MIN WAGE-PRNC)	65.000	175.000	275.000	1,10
278.000	122.434	100.000	1*(0.75 MIN WAGE-PRNC)	53.000	175.000	275.000	0,99
386.004	170.000	100.000	1*(0.75 MIN WAGE-PRNC)	5.000	175.000	275.000	0,71
454.122	200.000	100.000	0	0	200.000	300.000	0,66
567.653	250.000	100.000	0	0	250.000	350.000	0,62
681.183	300.000	100000	0	0	300.000	400.000	0,59

Note: The table assumes that individuals contribute for 30 years, with returns of 4.5% in the accumulation period and 3.5% in the period of dis-accumulation. It also assumes that all individuals belong to families that are among the 80 % most vulnerable of the country.

### Principal beneficiaries of the new system in Proposal B

As seen in Table 2, the new system identifies several groups of beneficiaries.

With respect to the coverage of the PBS to alleviate poverty

1. Coverage extends to beneficiaries belonging to 80 percent of the poorest families.

### With respect to the coverage of benefits that smooth consumption

1. The new system rewards those who contribute. This is because of how the notional accounts operate and of the how the benefits are determined by the type of pension, based on the accumulated balance and life expectancy at retirement. It is a defined contribution approach.

- a. For people who contribute based on incomes that are over \$350,000:

- i. For the share of their income that they pay into the SRNC, they receive a pension that reflects their accumulated capital, based on the rate of the return of the notional accounts and on their life expectancy at retirement.
- ii. Eventually they may receive a small supplement from matching funds.
- iii. For the share of their income that they contribute to the SCI, they will receive their pension from the AFP they have selected to administer their funds.
- iv. If they belongs to the poorest 80 percent of families, they will also have access to the PBS.

In short, if they meet the eligibility criteria, they will receive the PBS, the social security pension (from the solidarity fund) and the pension from the AFP.

b. For people who contribute based on incomes that are lower than \$350,000:

i. For the share of their income that they pay into the SRNC, they receive an annuity based on their accumulated capital, reflecting the rate of the return of the notional accounts and on their life expectancy at retirement.

ii. If the pension is less than 75 percent of the minimum wage, the accumulated balance is complemented with matching funds and the affiliate also receives the PBS.

iii. The affiliate receives the PBS if they belong to the poorest 80 percent.

2. The system progressively transfers solidarity contributions to the segments of the population with the lowest income who will obtain replacement rates that are much higher than what they would receive solely through their own contributory efforts (Column 8 and 9). Given the actuarial calculations based on the structure of contributions from Table 1, it would be preferable that the system privilege women.

3. People with taxable incomes that are higher than \$350,000 receive an annuity that corresponds to their contribution to the SRNV as well as an annuity from the SCI. Depending on the rates of return, it is possible that they will also receive a small supplement of matching funds. If they belong to the poorest 80 percent of families, they will also receive the PBS.

### **In the contributory phase,**

1. By matching contributions for those people with lower incomes, the proposal creates an incentive structure that does not currently exist. People will know that for every peso that they contribute into their pension account, they will receive a matching complementary contribution.

2. The low-income affiliate will not be forced to deal with managing their pension account but will be continuously informed of the balance of the account.

### **Focus on gender**

The system can incorporate adjustments that foster inter-gender solidarity to offset the lower contribution levels of women, due to their more limited and irregular work histories, by transferring solidarity contributions into their accounts through the social security fund. This would ensure a basic floor for old-age pensions from the contributory system, which would also be supplemented with the basic solidarity pension.

### **Critical factors of success of the new system**

There are some basic conditions that must be met for the new system to be implemented successfully, namely:

1. The cut off point for level of taxable income that separates the two halves must be set: the contributions that go to the solidarity component (SRNC) must be divided from the contributions going to the AFP (the SCI). For purposes of this presentation, we set the cut off level at \$350,000, leaving half of the flow of savings in the AFP system and sending the other half into the system of collective savings. That cut off income level must be continuously updated so that it is indexed to the average income of workers. The cutoff point should be legally institutionalized to ensure that the system always separates contributions, sending an equal amount to the solidarity fund and to the AFP system.

2. The solidarity fund must have dedicated funding, which means that the resources generated by the system (from the contributions of workers, employers and the Treasury), can only be used to fund pensions. This should be established legally, using a criteria that is similar to that used for the current pension reserve fund.

3. The institution in charge of the system (for the clearing house, the registration of accounts, information, annuities and which could be

the IPS) should have autonomy and independence. This institution responsible for the administration of the solidarity fund should carry out the relevant actuarial calculations to ensure the long-term financial sustainability of the system. It should also adjust the amount of income that separates the contributions that go to each part of the system, to ensure that the distribution is always around 50% / 50%.

4. The mechanism of allocating the matching contribution (financed by employer and state contributions) must be established for each benefit funded by personal contributions ("the self-financed pension"). This proposal could double the pension amount that would exist if the pension were only self-financed. This increase could be granted up until it reaches 75% of the minimum wage.
5. The beneficiaries belonging to the first four quintiles (the poorest 80% of families) will re-

ceive the PBS in addition to the above benefits.

6. The centralized administration would lower costs (for example, in Sweden the cost is 0.41 % of salary). Nevertheless, it requires a new institution which can be built on the 2008 reform.
7. In terms of financial savings for financial intermediation, the proposal moves about half of the flow away from the AFP system, it gets a matching contributions from the State and from employers and what is not used to improve current pensions is administered by the Pension Reserve Fund as financial savings for financial intermediation. This means that about 1.3% of GDP would go to a solidarity pension fund, which, with respect to surplus savings, would be administered similarly to the current pension reserve fund.

### Effects in terms of financial savings (In percentage of annual GDP in 2013 \$ 137,212,064)

- **Current situation (data from December 2013 in millions of common pesos)**

- o Total collection from men (millions) \$ 2,286,872 (1.7 % GDP)
- o Total collection from women (millions) \$ 1,290,955 (0.9 % GDP)

- **Proposed situation**

- o Collection from subsystem of notional accounts
  - Collection from men (millions) \$ 1,102,234 (0.8 % GDP)
  - Collection from women (millions) \$ 705,077 (0.5 % GDP)
  - Total matching (millions) \$ 1,807.311 (1.3% GDP)
- o Collection from subsystem of individual capitalization
  - Collection from men (millions) \$ 1,184,638 (0.9 % GDP)
  - Collection from women (millions) \$585,879 (0.4 % GDP)

### Conclusions:

Our proposal represents a new social contract for senior citizens. It restores public legitimacy in the system by: (i) cementing a floor of social protection with a sufficiency threshold that ensures an adequate level of income in old age; (ii) introducing endogenous solidarity in the system; (iii) using a redistributive framework to foster intra and inter-generational solidarity and inter-gender solidarity; and (iv) building a social

security system with a logic of rights: establishing a solidarity fund to ensure that people with lower-income people receive incomes in their old age.

This can all be accomplished on the basis of a sustainable long-term funding, without affecting the existing rights acquired by people to the savings in their individual capitalization accounts.

## Appendix Proposal B: Fundamental Elements of Proposal B

### 1. Changes to the non-contributory solidarity pillar

- a. Income:
  - I. New resources from general taxation of 0.27% of GDP to expand coverage of the PBS to up to 80%. (We apply rule of three).
- b. Benefits:
  - I. Affluence test to extend the PBS to 80%.
  - II. 20% increase of the Basic Solidarity Pension.
- c. Horizon of change: dependent on legal reforms, and would be implemented gradually according to available resources.
- d. Impact on poverty. Like the other proposals, we are unable to estimate this effect. But the replacement rates for lower income people would be higher, see the Table.

### 2. Changes to the AFP pillar

- a. Income:
  - I. People who earn less than \$350,000 and those who earn more than \$350,000 for the first \$350,000, will contribute to new pillar.
  - II. We estimate that half of the current flows (2.6% of GDP) that now go to the AFPs will go to the new pillar (1.3% of GDP).
- b. Benefits:
  - I. Benefits from the capitalization component in the form of annuities, according to specific proposals
  - II. Those who belong to the poorest 80% of the population will join the PBS and PRNC.
  - III. Those who belong to the richest 20% will join the PRNC.

### 3. Other Changes in the Creation of a Social Security Pillar

- a. Income:
  - I. Creation of a fund of pooled contributions, equivalent to 1.3% of GDP.
  - II. Establishment of matching funds for those contributions.
- b. Benefits:
  - I. Payment of the matching funds for current pensioners whose pensions will improve with the matching according to the formula for benefits (0.4 % of GDP).
- c. Collective savings:
  - I. The net balance between the contributions complemented by matching funds and those used to improve pensions are added to the contributions and fed into the collective savings account. The balance is invested collectively and with the same safeguards that govern the AFPs, without requiring the affiliate to make additional decisions.
- d. Administration of notional accounts:
  - I. They use notional registry accounts to estimate future pensions and actuarial studies.

### 3. GLOBAL PROPOSAL C: *Rebuilding the public PAYG system in Chile*

**Leokadia Oreziak, based on Centro de Estudios Nacionales de Desarrollo Alternativo (CENDA), ESTUDIO: “VIABILIDAD FINANCIERA DEL SISTEMA DE PENSIONES BASADO EN EL ESQUEMA DE TRANSFERENCIAS INTERGENERACIONALES EXPLÍCITAS EN CHILE”** (<http://www.previsionsocial.gob.cl/>)

(STUDY: “FINANCIAL VIABILITY OF A PENSION SYSTEM BASED ON A SYSTEM OF DIRECT INTERGENERATIONAL TRANSFERS IN CHILE” Bid ID: 1592-B-LE14, Responsible for this bid: Undersecretary of Social Security, Ministry of Labor—Undersecretary of Social Security)

#### 1. Background

*The opinions expressed during the public hearings (held in 2014 by the Advisory Pension Commission in Santiago and regional meetings) by organizations, institutions and individuals defending both present and future pensioners’ interests should be the starting point for designing pension reform. The AFP system is seen as illegitimate because it was created and imposed in the 1980s during the military dictatorship and as inefficient because it has not complied at all with the primary objectives of its creation and means poverty for pensioners. The survey involving more than 22,000 people shows that 91% of them say the system does not deliver decent pensions; 92% do not approve of the AFPs.<sup>112</sup>*

The system of individual capitalization failed because it was not designed as a social security system but as an auxiliary system for capital market development. The present AFP system is unfair and inequitable for the affiliates. The risk of loss of the funds is taken on almost exclusively by the contributors. Over 30 years in existence, the AFPs show that those who retire now will be much poorer than those who retired in the old system. In spite of the high growth process of the economy and tripling of the GDP, pensions have fallen to one-third of average wages.

<sup>112</sup> Citizen Consultation carried out by Movimiento Aquí la Gente, applied to 22 thousand people and presented to the Commission on October 28, 2014 <http://www.comisionpensiones.cl/index.php/movimiento-aqui-la-gente-se-reune-con-david-bravo-y-entrega-resultados-de-consulta-ciudadana-sobre-sistema-previsional/>

#### 2. General and specific objectives of the proposed reform

The general objectives of the proposed reform are:

- » Address the most pressing current issue: low contributory pensions,
- » Improve redistribution of income and reduce poverty in old age and,
- » Achieve these objectives in a sustainable manner, financially and fiscally, in the short and long run.

**The specific objectives of the reform is to achieve a substantial rise in current pensions, and a reduction in effective retirement age, especially those of women, together with terminating direct and indirect fiscal subsidies to contributory pensions, and reducing the proportion of non-contributory pensions while increasing the amount of lower ones. To achieve all this, the proposal assumes that all affiliates to the current AFP pension system are transferred to the public PAYG scheme, with their pension contributions and funds, in exchange for better, defined, lifelong, non-discriminatory, pensions, with normal associate benefits for surviving members of the families.**

#### 3. Details of the proposal

##### 3.1. Design

The proposal is designed in accordance with, on one hand, conservative growth projections of population, number of contributors, Gross Domestic Product (GDP), wages, and fund yields, all of which are interrelated, and determine one another, in defined relation, calculated by a regression model. On the other hand, the future number of pensioners is calculated with accuracy, with an actuarial method, from the known number, current ages, and mortality and disability rates, of affiliates to the AFP system. Retirement age, initial increase in average pensions, and the proportion of elders attended by non-contributory system, are set as main parameters; increases in average wages and pensions, and fund yields, are assumed equal to GDP growth. With this information, the model calculates yearly cash in-

flows, and outflows and the resulting value of the pension fund, adjusting the parameters to ensure a positive value of the latter.

All these calculations are replicated for an eventual, alternative, capitalization system, run by the State at zero cost, meaning that private AFP disappear, and all contributions go to the fund, without discount for fees or disability; under the same projections for population, contributors, GDP and wages, and the same parametric assumptions for retirement ages, contribution rates, and proportion of elder in the non-contributory system. The calculation of future pensions from the capitalization scheme is based in the known accumulated savings of the different age cohorts of affiliates in December 2013, the accumulated contributions of each cohort until retirement, and their life expectancy at that moment.

The model also calculates the fiscal expenditure in civilian pensions, including direct and indirect cash subsidies for contributory pensions, and expenditure in non-contributory pensions, as well as the net surplus of cash inflows and outflows of the pension system, for each of the above scenarios and alternatives.

### **Population, contributors, GDP, wages, and pension fund yield**

The model is based in a conservative **CELADE 2010** population projection (19.4 million inhabitants in 2100), with zero immigration considered.

The number of contributors is estimated as an increasing proportion—which is consistent with well-known rapid increase in participation rates and, at the same time, in the proportion of salaried employment, in emergent economies—working age population, which in turn depends on parametric retirement age assumptions. The parametric proportion of contributors to active age population is adjusted to ensure that the implicit rates of GDP growth are conservative.

The projection model adjusts the ratio of contributors to working age population, to ensure conservative growth rates (1.3 to 1.4 percent per year) in the number of contributors and, consequently, real growth in GDP, average wages, and pensions, and pension fund yield. GDP growth is estimated from the number of contributors, according to the above mentioned regression for-

mula, and growth in the other mentioned variables is assumed equal to GDP growth.

To achieve these rates of economic growth with the conservative population projections used in this model, the parametric rate of contributors to working age population must rise gradually to reach 74,5 % by mid-century. This seems reasonable, because currently (2013) this rate is already over 60 % for affiliates aged 30 to 40 years old, which cover over 95 % of active population for the same age cohorts. In this respect, it seems interesting to note that among early affiliates to the AFP system, who came from the old PAYG scheme whose jobs were relatively less precarious; the proportion of contributors to affiliates was over 75 % back in year 1985.

It must be mentioned that the assumption for wage level is also very conservative, because it assumes that they will grow at the same rate as GDP, which implies no improvement in distribution of income, which is presently very unfair for wage earners, which receive less than 35 per of GDP (2007). It seems reasonable to assume that this should change in the coming years as the country continues to democratize, and average wages should grow faster than GDP for quite some time, but this is not considered in the model.

### **Retirees**

On the other hand, the model estimates the number of beneficiaries, based on the current number of pensioners, and the number of active affiliates, of the AFP system. The latter, which is available for ages 15 onwards, is in fact a quite precise census of the overall active population, because each individual is identified by his or her unique ID number (RUT), sex, age, and savings, in their individual pension fund account, and the activity of the accounts is checked every month.

The number of affiliates in cohorts aged 35 to 55 years is already almost equal to the full number of persons in the overall population of the same age (98% in the case of 35-45 age cohorts), evidently for both sexes.

The younger cohorts are smaller, because they enter the salaried workforce gradually, until almost everybody aged 35 has worked at least once as a salaried employee. Consequently they are registered as affiliates to the pension

system, with an individual savings account which is checked every month until his or her retirement or disability, after which they are reclassified in the appropriate passive categories and continue to be checked monthly, until death. The rates of affiliation of the younger generations are well known, and adjustments in their number to reflect the overall population are easy to consider, as is done in the model.

The current older cohorts are also smaller, because they correspond to the early affiliates to the AFP system, many of which were transferred from the old public pension system, generally forced to do so in the 1980s. However, as they retire and the following –larger – generations advance in age, the total number of affiliates will soon represent the full working age population, once the adjustments in the number of the younger cohorts are made.

The above information, adjusted by known tables of mortality and disability, results in an accurate estimate of the yearly cohorts of new pensioners, well into the second half of the present century, depending on the parametric retirement ages.

The total number of pensioners for each year is estimated as, pensioners of the previous year, minus mortality and disability, plus the cohort of new pensioners. If the number of pensioners exceeds the parametric proportion of elderly attended by the public, non-contributory system, the overflow is transferred to the latter.

The model assumes that, initially, all active persons surpassed legal retirement age, which currently represent about 28 % of total AFP pensioners 37.9 % of old age pensioners and are mainly women, effectively retire in the first year, with the same average pensions as current retirees.

### Calculations and sustainability criteria

The proposal is sustained by a projection model, based on the above described estimates of the number of contributors, which in turn are based on population and GDP statistics, and the number of active affiliates by age, and pensioners, of the AFP system. The main parameters of the model are: 1) initial increase in the average pensions, for all current pensioners, with the addition of all active affiliates who have reached or exceeded retirement age, 2) legal retirement age,

3) contribution rates as a percentage of wages, 4) percentage of old age population attended by the public, non-contributory, schemes. The financial sustainability criterion of the model is that the final value of the pension fund should be positive. The fiscal sustainability criteria is that overall State expenditure in civilian pensions falls consistently as a percentage of GDP.

The model calculates cash inflows and outflows, and the eventual surpluses and deficits are transferred, or covered, by the pension fund, which yields at the same rate as GDP growth. Cash inflows are estimated for each year, multiplying the number of contributors by the parametric contribution rate, and the average wages, which also grow at the same rate as GDP, starting with the average wage of AFP contributors in December 2013. GDP growth is calculated according to the estimated number of contributors, with the above mentioned regression formula. The number of contributors, and consequently GDP growth, depend on the parametric assumptions on retirement age, because the former are calculated as a parametric proportion of the working age population.

During the first decades, payments by insurance companies to retirees who have contracted pensions with them are considered a cash inflow by the model. These payments should continue until the beneficiaries pass away, because the full amount of their pension funds was appropriated in advance by the insurance companies.

Cash outflows are calculated, multiplying the number of pensioners, including those in insurance companies, by the average pensions. The former are predicted accurately from the AFP passive and active affiliate database, and adjusted according to the parametric retirement ages of men and women. The total number of pensioners is checked with the total number of persons past the parametric retirement age, and the parametric proportion of non-contributory pensioners. The eventual overflows are transferred to the non-contributory pension system. The average pensions are calculated for each year, as the previous year average increased by estimated GDP growth rate, starting from the average pensions in December 2013, after applying the parametric initial increase.

Fiscal direct subsidies to AFP pensions, so as “recognition bonds”, “solidarity complements (APS)”,

and others, are terminated from the first year in the new PAYG system. These subsidies presently represented 1.2 % of GDP in 2013. Indirect subsidies such as “retirement plans and bonus” and others represented around an additional 0.6 % of GDP the same year, not counting tax credits for high income “voluntary savings plans (APV), which are also considerable.

On the other hand, the number of non-contributory pensions, including “solidarity basic pensions (PBS)” and pensions from the old PAYG system and others, all of which are paid almost entirely out of the fiscal budget, covered 63 % of elders and represented 2.1 % of GDP in 2013. Together with the above subsidies to AFP pensions, fiscal expenditure in civilian pensions amounted to 3.9 % of GDP in the same year. All this fiscal expenditure is drastically reduced almost by half, to 2 % of GDP, during the first year of the new PAYG public scheme (2014), since all direct and indirect subsidies to AFP pensions are terminated.

During the following years, the important increase in the number of contributory pensions allows for a continued reduction in the number of non-contributory pensions, with the consequential reduction in fiscal expenditure as a percentage of GDP. According to the different scenarios analyzed, and in dependence to the parametric values of retirement age, contribution rates, and proportion of elders in the non-contributory system, fiscal expenditure in civilian pensions is reduced by an additional 0.4 % to 1.3 % of GDP, by mid-century, according to different scenarios.

At the same time, the above allows for a significant improvement in the average value of “solidarity pensions” paid to the poorest retirees. This can be achieved even with a constant average value of non-contributory pensions, because the current proportion of “solidarity pensions” (583,202 beneficiaries in December 2014) and those from the old PAYG scheme (799,361), will shift in favor of the former because most of the latter will pass away. As the average value of the former is much lower (87.000 CLP a month) than the latter (228,000 CLP), the gradual replacement of one by the other, allows a considerable increase in the lower pensions, even while maintaining a constant average value of non-contributory pensions. However, the proposal assumes that part of the significant fiscal savings in direct and indirect subsidies (1.8 % of GDP per year)

should be used to provide an initial increase in non-contributory Basic Solidarity Pensions “Pensiones Básicas Solidarias (PBS)”, and some very low pensions in the old PAYG system for people who retired in the 1980s and early 1990s, at least to the level of the minimum contributory pension, which in any case would at least double the current level.

The model also calculates the pensions that could be paid by the current capitalization scheme run by the State at zero cost, for each scenario number of contributors, GDP growth, average wages, contribution rates, retirement ages, and proportion of elderly in the non-contributory system. The calculation is done by accruing the known average savings for individuals in each age cohort in December 2013, by the number of years until retirement age, and the pension fund yield. In addition, the fund at retirement is increased by the accumulated future value of individual contributions, calculated as the product of average wages and contribution rates for each year, accrued by the same yield. The accumulated fund at retirement is then divided by the average number of months that each age cohort expects to life, accruing the remaining fund at the pension fund yield to receive equal pensions all along.

It is also assumed that this alternative pension scheme would be administered by the State at zero cost, meaning that the full amount of the contributions go to the pension fund, without discounts for fees, or even for disability insurance – through both items, the AFP system now appropriates 1/5 of contributions.

Even under this quite favorable assumptions, it is significant to confirm that even in scenarios of significant increase in contribution rates and retirement ages, the average value of pensions financed by individual capitalization end up in 2052 in the range of 20 % of average wages, even lower than the 32 % replacement rate of current pensions (2013), which of course include considerable State subsidies, or about one third of the replacement rate of pensions paid by the new PAYG scheme.

In each scenario, and both for the PAYG, and an eventual capitalization system run by the State at zero cost, the model also calculates the fiscal cost in civil pensions. In the case of the latter sys-

tem, it includes the direct and indirect cash fiscal subsidies to self-financed contributory pensions, needed to raise their average value to the same amount as PAYG pensions. The average value of pensions in this eventual system includes two terms, on the one hand, the number of pensioners times the average value of pensions in December 2013 plus, on the other hand, the product of the number times the self-financed pension of the successive new cohorts. The former include direct subsidies, which are included in the calculations and decline in time as the initial pensioners pass away. In both systems, the fiscal cost includes expenditure in non-contributory pensions.

As said, the model also calculates the present value of surplus or deficit, transferred or withdrawn from the pension fund, both for the PAYG and an alternative capitalization system run by the State at zero cost. The accumulated results are presented as percentage of 2013 GDP.

### 3.2. Transition mechanism

There is no need for any specific transition mechanism.

## 4. Expected results

The results of the projection model for the new PAYG system are presented under two sets of preferences, both of which initially consider significant initial reduction in effective retirement age and increase in average pensions, and the immediate elimination of all direct and indirect cash fiscal subsidies to contributory pensions from the new PAYG system and rapid reduction in the proportion of elderly in the non-contributory system. Both scenarios stress early retirement ages and low contribution rates, even at the expense of less acute reduction in fiscal expenditure in non-contributory pensions, and lower final value of the pension fund. Both scenarios assume that the proportion of elderly attended by the non-contributory public system is reduced, from the current 63 % of total population passed legal retirement age (real figure for December 2014), to 40 % in the 2020s.

In the first scenario legal retirement age (65/60), is not changed at all and will be at the current level (December 2014) all along, or in the second scenario will be raised gradually only by two years starting in 2030. The contribution rate will be at the current level 12.6 % of wages until 2035 in the first scenario and until 2031 in the second one. All monetary figures are expressed in CLP of December 2013.

Summary projection results are presented for year 2052, because until this year all CELADE population estimates are fairly similar. As said, all population estimates are conservative, especially beyond mid-century, because they consider zero immigration. Nevertheless, all results, for every scenario, are estimated until the latest year for which the number of pensioners may be calculated from the current (December 2013) affiliate database, which depends in each case on retirement age assumptions.

All scenarios assume that every affiliate who has surpassed legal retirement age in December 2014, will retire in that same month, which means an initial reduction in effective retirement age, from the current average of 70 years old for men and women, estimated by OECD, to the current legal entitlement of 60 and 65 years old, respectively. All scenarios, as well, assume important increases in initial average pensions. Likewise, all

scenarios assume that direct and indirect cash fiscal subsidies to contributory PAYG pensions are ended from the very start.

Alternatively, for all the above scenarios, using the same assumptions for each, the model calculates the value of self-financed pensions provided by a capitalization scheme fully administered by the State at zero cost (no longer by private AFP that charge fees). Under this alternative, the model calculates resulting fiscal cost in civilian pensions, including direct and indirect

cash subsidies required to elevate the average value of pensions provided by this capitalization scheme, to the same level provided by the new PAYG system, and the expenditure in non-contributory pensions, which is equal for both systems, because it depends on the proportion of elderly in this system. On the other hand, the model calculates the net surplus that both systems transfer to the financial markets.

The results are summarized in tables 1 and 2, below.

 **Table 1: Pension reform scenarios - Summary**

New public PAYG pension system replaces AFP in 2014	Increase in initial average pensions, additional scenarios:			
	75%		100%	
Retirement age M/W in 2052	65	60	67	62
Contribution rate in 2014 / 2052	12,7%	24,6%	12,7%	24,6%
PAYG replacement rate (average pension / average wage) in 2014 / 2052	56%	56%	64%	64%
Comparative AFP run by the State at zero cost and no direct subsidies, savings-funded pensions, replacement rate in 2014 / 2052	27%	21%	27%	24%
Non-contributory system coverage, including "solidarity" and old PAYG system pensions, in 2014 / 2052 (% of elderly)	63%	40%	63%	40%
Non-contributory, "solidarity" and old PAYG system pensions, in 2014 / 2052 (million pensions)	1,4	2,1	1,4	1,9
Fiscal expenditure in civil pensions with new PAYG system, in 2013 / 2052 (% of GDP)	3,9%	1,9%	3,9%	1,7%
Present value of fiscal expenditure in civil pensions, with the same replacement rates, accumulated 2014-2052 (% of 2013 GDP), with: new PAYG system / State run AFP at zero cost	72%	495%	67%	540%
Present value of surplus transferred to financial markets, accumulated from 1982 to 2052, with: new PAYG system / State run AFP at zero cost	4%	249%	4%	281%
Pension fund value in 2013 / 2052 (trillion CLP)	84,4	16,4	84,4	13,8
Increase in the number of contributors (% per year)	1,24%		1,36%	
Implicit GDP, average wage and pension, real growth (% per year)	1,30%		1,42%	

Source: CENDA, STUDY: "FINANCIAL VIABILITY OF A PENSION SYSTEM BASED ON A SYSTEM OF DIRECT INTERGENERATIONAL TRANSFERS IN CHILE" Bid ID: 1592-B-LE14, Responsible for this bid: Undersecretary of Social Security, Ministry of Labor—Undersecretary of Social Security; based on Chilean Pension Superintendence, Chilean Central Bank, CELADE, UNDESA, WB

**Table 2: Pension reform scenarios – Contribution rates and Retirement ages (New public PAYG pension system replaces AFP in 2014)**

Scenarios (Increase in initial average pensions)	Contribution rate		Retirement age	
	Period	Rate	Period	Age (M/W)
75%	2014-2034	12,6%	2014-2068	65/60
	2035-2068	24,6%		
100%	2014-2030	12,6%	2014-2029	65/60
	2031-2068	24,6%	2030-2039	66/61
			2040-2068	67/62

Source: CENDA based on Chilean Ministry of Labor, Undersecretary for Social Security, based on Chilean Pension Superintendence, Chilean Central Bank, CELADE, UNDESA, and WB.

#### 4.1. Effect on future pensions (pension amounts and replacement rates)

As said above, in both scenarios, the model assumes that all affiliates passed legal retirement age of 60 for women and 65 for men, in December 2014; effectively retire that month, with the same average pension of 183,212 CLP of December 2013. This means increasing the 676,836 old age pensioners in the AFP system in December 2013 by 291,736 pensioners, or 38 per cent, and reducing effective retirement age by ten years for women and 5 years for men, from their current averages of 70 years old, estimated by OECD.

##### 4.1.1 First preferred scenario, 75% increase in initial average pensions

The first preferred scenario, assumes no changes whatsoever in legal retirement ages of neither women nor men, which continue in the current 60 and 65 years old, respectively, until 2052.

This scenario is sustainable with an initial increase of 75% in average pensions for all retirees in December 2014, which include all affiliates past retirement age, as said. Initial average pension is raised from 183,212 CLP to 324,800 CLP, and then increased yearly at the same rate as GDP growth, to reach 531,131 CLP in 2052. Wages also grow at the same rate as GDP, to reach 955,903 CLP in 2052.

Replacement rate of average pensions is raised from 32 % of average wages of pension contributors, in December 2013, to 56 % in December 2014, and sustained at this level all along.

In this scenario, contribution rates are kept in their current level of 12.6 % of wages until 2035, at the expense of lowering the pension fund. Then, contributions need to be raised to 24.6% of wages, to balance cash inflows and outflows until 2052. The pension fund value is reduced from 84.4 trillion CLP in December 2013, to 16.4 trillion in 2052.

In this scenario, which considers no increases in legal retirement age, contributors grow at an average rate of 1.24% per year, and GDP –which is estimated by the model, based on the number of contributors, by the above described regression formula–, grows at an average rate of 1.3 % per year, the same rate as wages, pensions, and pension fund yield.

Under the same assumptions of total yearly contributions, an eventual alternative capitalization scheme, entirely run by the State (no private AFP) at zero cost and not considering disability insurance cost, meaning the full amount of yearly contributions are capitalized, would be able to finance replacement rates of 27 % of average wages in 2014 and 21 percent in 2052.

##### 4.1.2 Second preferred scenario, 100% increase in initial average pensions

The second preferred" scenario, is sustainable with an initial increase of 100% in average pensions for all retirees in December 2014, which include all affiliates past retirement age, as said. Initial average pension is raised from 183,212 CLP to 371,637 CLP, and then increased yearly at the same rate as GDP growth, to reach 635,564 CLP in 2052. Wages also grow at the same rate as GDP, to reach 1,000,875 in 2052.

Replacement rate of average pensions is raised from 32 % of average wages of pension contributors, in December 2013, to 64 % in December 2014, and sustained at this level all along.

Retirement ages are not changed until 2029, and the raised in 2030 to 61 and 66 years old for women and men, respectively, until 2039, when they are raised again, to 62 and 67 years old, and for women and men, respectively.

Contribution rates are kept in their current level of 12.6 per wages until 2030, at the expense of the pension fund. Then, contributions need to be raised to 24.6 % of wages, to balance cash inflows and outflows until 2052. The pension fund value is reduced from 84.4 trillion CLP in December 2013, to 13.8 trillion CLP in 2052.

In this scenario, which considers a small increase in legal retirement age, contributors grow at an average rate of 1.36% per year, and GDP—which is estimated by the model, based on the number of contributors, by the above described regression formula—, grows at an average rate of 1.42 % per year, the same rate as wages, pensions, and pension fund yield.

Under the same assumptions of total yearly contributions, an eventual alternative capitalization scheme would be able to self-finance replacement rates of 27 % of average wages in 2014 and 24 percent in 2052.

#### **4.2. Effects on redistribution and on poverty among the elderly**

All scenarios imply significant improvements in distribution of income, and reductions in poverty among the elderly.

In global terms, a surplus of cash inflows minus outflows of the AFP system of 3.5 percent of GDP in 2013, which was appropriated by the “industry” of AFPs and insurance companies, and transferred mostly to large business groups, is used in this proposal to increase pensions. That implies an immediate transfer of this sum, which is the equivalent of approximately 3.5 % of GDP, from business to labor, with the consequential impact in income distribution.

The present value—discounted at a long term rate equal to estimated growth of GDP— of net

yearly surplus cash inflows minus outflows, of the AFP system, accumulated from 1982 to 2013, amounted to 56 % of GDP of the latter year, meaning that the privatization of pensions has resulted in a net transfer to the financial system, of wages and State subsidies equivalent to over half of 2013 GDP.

The termination of this system and its replacement by a PAYG scheme, with a moderate reductions of the accumulated pension fund, results in a reduction of this accumulated net transfer, the present value of which, accumulated from 1982 to 2052, is reduced in to 4 % of 2013 GDP in the “preferred” scenarios. In comparison, the eventual continuation of a capitalization scheme, even under State administration at zero cost, results in a continued increase in the transfers from wages to the financial markets, the accumulated 1982-2052 present value of which grows to 249 % of 2013 GDP, and to 281 % of 2013 GDP, in the scenarios considered. This proves that the capitalization pension scheme results in sizeable—the present value of which accumulated until 2052, is roughly the equivalent of three times 2013 GDP—, an ever increasing, transfer of funds from labor to big business, mainly to the financial industry. The termination of this mechanism is one of the more powerful tools to improve income distribution.

## 5. Fiscal costs and Funding

The impact of the proposal over fiscal cost and funding is perhaps the largest, because the proposal:

1. Implies initially saving direct and indirect fiscal subsidies to the AFP system, which amount to 1.8 % of GDP (2013), in all scenarios considered, and;
2. The rapid reduction of the proportion of elderly in the public non-contributory system, and consequently the reduction of fiscal expenditure in this item, which presently is 2.1 % of GDP (2013). In the scenarios analyzed, this figure is reduced to a range of 1.6 % to 1.9 % of GDP, in the 2020s.

Adding both items, in the “preferred scenarios”, the yearly fiscal expenditure in civilian pensions is reduced from 3.9 % of GDP in 2013, to a range of 1.6 to 1.9 % of GDP per year in the 2020s, a total reduction of 2.0 to 2.2 % of GDP per year. The above figures are considering the preferred scenarios, where the proportion of elderly remains in the non-contributory public pension system is reduced from the current 63 % to 40 % in the 2020s. It may be assumed that the State will spend fiscal savings in education – only the direct subsidies are the equivalent of the cost of gratuity in tertiary education– or other related social policies, which benefit labor and the poor, and improve income distribution.

It is interesting to note that an eventual continuation of the capitalization scheme would result in large increases in fiscal expenditure in civil pensions, even under exclusive State administration at zero cost, without private AFP, and considering the same projections of growth in population and the number of contributors, and the resulting growth in GDP and wages, and under the same assumption of retirement ages and contribution rates as in the scenarios calculated for the PAYG scheme. Under the assumption that pensions paid by the State run capitalization scheme deliver the same replacement rates as the PAYG system, the implied fiscal subsidies would grow to an accumulated 2014-2052 present value equivalent to five or five and a half times 2013 GDP. The comparative accumulated fiscal expenditures in non-contributory pensions in the case of

PAYG contributory system, adds up to a range of 67 % to 72 % of 2013 GDP, in accumulated present value, from 2014 to 2052.

The overall conclusion is that the continuation of the capitalization scheme, even under State administration, results in the quite unreasonable situation of spending considerable fiscal resources to supplement insufficient self-financed pensions meanwhile, at the same time, transferring roughly three times 2013 GDP, in accumulated present value, in net surplus of cash inflows minus outflows, from such a “pension” system, from Chilean labor, mostly to big business and the international financial markets.

## 4. Counter-Arguments

### A. Why doesn't the Commission support a proposal to transform the pension system into a pay as you go system (Global Proposal C)?

Of a total of 24 Commissioners, only one Commissioner supported Proposal C, which proposes replacing the current system with a pay as you go (PAYG) system. Why didn't the Commission as a whole endorse the proposal to move to a pay as you go system? The commissioners' main reasons for opposing the proposal included:

- a) Proposal C transfers worker-owned contributions and savings to the PAYG system, without any compensation for taking their individual accounts;
- b) The proposal requires an abrupt and large increase in contributions/taxes at the time that the reserves are depleted;
- c) Moving to a full-PAYG reduces savings and therefore investment, which is extremely problematic when the labor force is facing a decline;
- d) The assumptions that the proposal makes are overly optimistic: increases in the contribution rate and the retirement age that are not feasible, optimism with regards to increasing labor formality and conservative assumptions with regards to the coverage of seniors. These assumptions produce a parametric reform to make the system meet the proposal's objectives but the bases of these assumptions are outside of what can be realistically expected from the Chilean labor market.
- e) The problematic assumptions described in d), cast doubt on the financial sustainability of proposal C.

### B. Counter-arguments to Global Proposals A and B

The arguments made by the 12 commissioners who supported proposal A over proposal B are summarized as follows:

*Proposals A and B broadly suggest the same increase in benefits. The fundamental difference lies in how each proposal seeks to finance the*

*increase. Proposal A is designed not only to pay higher benefits now but also to ensure the ability of the system to pay promised pensions in the future. There are four sets of objections to proposal B:*

- (1) The proposal reduces savings and investment, harming future living standards and making it harder to finance future pensions;*
- 2) In addition, in the face of a decline in the labor force, a Notional Defined Contribution (NDC) plan has an inbuilt growing deficit, creating a downward spiral towards higher taxes, or further reductions in saving, or failing to keep pension promises;*
- 3) Administrative costs, including set up and running costs, are significant;*
- 4) The redistributive effects are poorly defined.*

For its part, the arguments of the 11 commissioners who supported Proposal B over Proposal A are as follows:

*Proposal A maintains most of the characteristics of the current pension system and is insufficient to fulfill the objective of sustainably improving the system's coverage and pension amounts. Proposal A:*

- (1) Fails to appreciably improve the pensions of current and future pensioners;*
- 2) Does not create a new social contract that would give the pension system legitimacy;*
- 3) Given this context, the proposal does not allow for the creation of opportunities for a social consensus to accept the parameter changes required to provide the system with long-term viability;*
- 4) Continues to put most of the risks of investment on workers in the sense that they are the ones who must face the uncertainty of benefits from a contributory component that is entirely capitalized;*
- 5) Does not reverse the current major gender inequalities;*

6) *Does not generate adequate incentives to increase the participation of self-employed workers in the pension system, nor does it increase the density of contributions for all workers*

7) *Does not reduce system costs by centralizing the system's administration in a way that would take advantage of economies of scale.*

For her part, the only commissioner who supported proposal C, criticized both the proposals A and B:

- » Proposal A aims to maintain the current system design at the cost of greater fiscal cost of subsidies, increases in the contribution rate and the retirement age.
  - » Proposal B is incapable of resolving the principle problems of the current system.
-

## Appendix No. 5: Votes on Specific Proposals Approved by the Commission

### 1. Strengthening and expanding the Solidarity Pension System

**Proposal 1: Expand the Solidarity Pension System to cover at least 80% of the population.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala 2. Orazio Attanasio 3. Nicholas Barr 4. Fabio Bertranou 5. David Bravo 6. Regina Clark 7. Carlos Díaz 8. Hugo Cifuentes 9. Christian Larraín 10. Costas Meghir 11. Carmelo Mesa-Lago 12. Olivia Mitchell 13. Verónica Montecinos 14. Leokadia Oreziak 15. Joakim Palme 16. Ricardo Paredes 17. Marcela Ríos 18. Claudia Robles 19. José Luis Ruiz 20. Claudia Sanhueza 21. Jorge Tarziján 22. Sergio Urzúa 23. Andras Uthoff	23
<b>Against</b>	1. Martín Costabal	1
<b>Abstention</b>		0
<b>TOTAL</b>		24

**Proposal 2: 20% increase in the amount of the Basic Solidarity Pension and the Maximum Pension with Solidarity Contribution.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala 2. Orazio Attanasio 3. Nicholas Barr 4. Fabio Bertranou 5. David Bravo 6. Hugo Cifuentes 7. Regina Clark 8. Martín Costabal 9. Carlos Díaz 10. Christian Larraín 11. Verónica Montecinos 12. Costas Meghir 13. Carmelo Mesa-Lago 14. Olivia Mitchell 15. Joakim Palme 16. Ricardo Paredes 17. Marcela Ríos 18. Claudia Robles 19. José Luis Ruiz 20. Claudia Sanhueza 21. Jorge Tarziján 22. Sergio Urzúa 23. Andras Uthoff	23
<b>Against</b>	1. Leokadia Oreziak	1
<b>Abstention</b>		0
<b>TOTAL</b>		24

**Proposal 3: Change the mechanism for accessing Solidarity Pension System benefits, from the current Instrumento Técnico de Focalización (a means test) to an affluence test.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala 2. Orazio Attanasio 3. Nicholas Barr 4. Fabio Bertranou 5. David Bravo 6. Hugo Cifuentes 7. Regina Clark 8. Martín Costabal 9. Carlos Díaz 10. Christian Larraín 11. Costas Meghir 12. Carmelo Mesa-Lago 13. Olivia Mitchell 14. Verónica Montecinos 15. Joakim Palme 16. Ricardo Paredes 17. Marcela Ríos 18. Claudia Robles 19. José Luis Ruiz 20. Claudia Sanhueza 21. Jorge Tarziján 22. Sergio Urzúa 23. Andras Uthoff	23
<b>Against</b>	1. Leokadia Oreziak	1
<b>Abstention</b>		0
<b>TOTAL</b>		24

**Proposal 4: Review current mechanisms for targeting non-contributory benefits, through more effective application and periodic verification.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala 2. Orazio Attanasio 3. Nicholas Barr 4. Fabio Bertranou 5. David Bravo 6. Hugo Cifuentes 7. Martín Costabal 8. Carlos Díaz 9. Christian Larraín 10. Carmelo Mesa-Lago 11. Olivia Mitchell 12. Verónica Montecinos 13. Leokadia Oreziak 14. Joakim Palme 15. Ricardo Paredes 16. Marcela Ríos 17. José Luis Ruiz 18. Jorge Tarziján 19. Sergio Urzúa 20. Andras Uthoff	20
<b>Against</b>	1. Regina Clark 2. Claudia Robles 3. Claudia Sanhueza	3
<b>Abstention</b>	1. Costas Meghir	1
<b>TOTAL</b>		24

## 2. Strengthen the contributory pillar, expanding coverage and contribution density

**Proposal 5: Create an institution capable of pro-actively coordinate policies for bringing affiliates into the system and collecting contributions.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala 2. Orazio Attanasio 3. Nicholas Barr 4. Fabio Bertranou 5. David Bravo 6. Hugo Cifuentes 7. Regina Clark 8. Martín Costabal 9. Carlos Díaz 10. Christian Larraín 11. Costas Meghir 12. Carmelo Mesa-Lago 13. Olivia Mitchell 14. Verónica Montecinos 15. Leokadia Oreziak 16. Joakim Palme 17. Ricardo Paredes 18. Marcela Ríos 19. Claudia Robles 20. José Luis Ruiz 21. Claudia Sanhueza 22. Jorge Tarzján 23. Sergio Urzúa 24. Andras Uthoff	24
<b>Against</b>		0
<b>Abstention</b>		0
<b>TOTAL</b>		24

**Proposal 6: Maintain the obligation for self-employed workers to make social security payments, as stipulated under Law 20,255 adapting its gradual implementation.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala 2. Orazio Attanasio 3. Nicholas Barr 4. Fabio Bertranou 5. David Bravo 6. Hugo Cifuentes 7. Martín Costabal 8. Carlos Díaz 9. Christian Larraín 10. Costas Meghir 11. Carmelo Mesa-Lago 12. Olivia Mitchell 13. Verónica Montecinos 14. Joakim Palme 15. Ricardo Paredes 16. José Luis Ruiz 17. Jorge Tarzján 18. Sergio Urzúa 19. Andras Uthoff	19
<b>Against</b>	1. Regina Clark 2. Leokadia Oreziak 3. Marcela Ríos 4. Claudia Robles 5. Claudia Sanhueza	5
<b>Abstention</b>		0
<b>TOTAL</b>		24

**Proposal 7: Remove a range of disincentives to contribute associated with other social programs such as FONASA, Family Allowances, and the assignment of a score for access to benefits of the Solidarity Pillar.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala	16
	2. Orazio Attanasio	
	3. Nicholas Barr	
	4. David Bravo	
	5. Carlos Díaz	
	6. Hugo Cifuentes	
	7. Martín Costabal	
	8. Christian Larraín	
	9. Costas Meghir	
	10. Carmelo Mesa-Lago	
	11. Joakim Palme	
	12. Ricardo Paredes	
	13. José Luis Ruiz	
	14. Jorge Tarzján	
	15. Sergio Urzúa	
	16. Andras Uthoff	
<b>Against</b>	1. Regina Clark	5
	2. Leokadia Oreziak	
	3. Marcela Ríos	
	4. Claudia Robles	
	5. Claudia Sanhueza	
<b>Abstention</b>	1. Fabio Bertranou	3
	2. Olivia Mitchell	
	3. Verónica Montecinos	
<b>TOTAL</b>		24

**Proposal 8: Modify the formula for the Social Security Targeting Score (Puntaje de Focalización Previsional) so as not to deter beneficiaries from joining the formal labor market.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala	15
	2. Orazio Attanasio	
	3. Nicholas Barr	
	4. David Bravo	
	5. Regina Clark	
	6. Martín Costabal	
	7. Carmelo Mesa-Lago	
	8. Joakim Palme	
	9. Ricardo Paredes	
	10. Marcela Ríos	
	11. Claudia Robles	
	12. José Luis Ruiz	
	13. Claudia Sanhueza	
	14. Sergio Urzúa	
	15. Andras Uthoff	
<b>Against</b>	1. Leokadia Oreziak	1
<b>Abstention</b>	1. Fabio Bertranou	8
	2. Hugo Cifuentes	
	3. Carlos Díaz	
	4. Christian Larraín	
	5. Costas Meghir	
	6. Olivia Mitchell	
	7. Verónica Montecinos	
	8. Jorge Tarzján	
<b>TOTAL</b>		24

### 3. Increase savings in the contributory pillar

**Proposal 9: Establish a new social security contribution payable by employers, amounting to 4%.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala	20
	2. Orazio Attanasio	
	3. Nicholas Barr	
	4. Fabio Bertranou	
	5. David Bravo	
	6. Hugo Cifuentes	
	7. Regina Clark	
	8. Martín Costabal	
	9. Carlos Díaz	
	10. Christian Larraín	
	11. Carmelo Mesa Lago	
	12. Olivia Mitchell	
	13. Verónica Montecinos	
	14. Joakim Palme	
	15. Marcela Ríos	
	16. Claudia Robles	
	17. José Luis Ruiz	
	18. Claudia Sanhueza	
	19. Jorge Tarzján	
	20. Andras Uthoff	
<b>Against</b>	1. Costas Meghir	4
	2. Leokadia Oreziak	
	3. Ricardo Paredes	
	4. Sergio Urzúa	
<b>Abstention</b>		0
<b>TOTAL</b>		24

**Proposal 10: Establish that at least a portion of the higher contribution of 4% paid by the employer will go to a solidarity fund.**

<b>OPTIONS (New contribution: Possible Distributions)</b>	<b>COMMISSIONERS</b>	<b>TOTAL</b>
<b>2% to the individual capitalization account and 2% to the Solidarity Fund</b>	1. Orazio Attanasio 2. Nicholas Barr 3. David Bravo 4. Carlos Díaz 5. Carmelo Mesa-Lago 6. Jorge Tarzján 7. Sergio Urzúa	7
<b>4% to the Solidarity Fund</b>	1. Regina Clark 2. Joakim Palme 3. Marcela Ríos 4. Claudia Robles 5. Claudia Sanhueza	5
<b>4% to the individual capitalization account</b>	1. Costas Meghir 2. Olivia Mitchell 3. Ricardo Paredes	3
<b>3% to the individual capitalization account and 1% to the Solidarity Fund</b>	1. Martín Costabal 2. José Luis Ruiz	2
<b>1% to the individual capitalization account and 3% to the Solidarity Fund</b>	1. Cecillia Albala 2. Fabio Betranou 3. Hugo Cifuentes 4. Christian Larraín 5. Verónica Montecinos 6. Andras Uthoff	6
<b>Abstention</b>	1. Leokadia Oreziak	1
<b>TOTAL</b>		24

**Proposal 11: Consider a transition period of at least four years for the proposed increase in the contribution rate, in order to reduce the negative effects on the labor market.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala 2. Orazio Attanasio 3. Nicholas Barr 4. Fabio Bertranou 5. David Bravo 6. Hugo Cifuentes 7. Regina Clark 8. Martín Costabal 9. Carlos Díaz 10. Christian Larraín 11. Costas Meghir 12. Carmelo Mesa-Lago 13. Olivia Mitchell 14. Verónica Montecinos 15. Joakim Palme 16. Ricardo Paredes 17. Marcela Ríos 18. Claudia Robles 19. José Luis Ruiz 20. Claudia Sanhueza 21. Jorge Tarzján 22. Sergio Urzúa 23. Andras Uthoff	23
<b>Against</b>	1. Leokadia Oreziak	1
<b>Abstention</b>		0
<b>TOTAL</b>		24

**Proposal 12: Establish a regulation that limits the portion of a worker's income that is not subject to social security deductions.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala 2. Orazio Attanasio 3. Nicholas Barr 4. Fabio Bertranou 5. David Bravo 6. Hugo Cifuentes 7. Martín Costabal 8. Carlos Díaz 9. Christian Larraín 10. Costas Meghir 11. Carmelo Mesa-Lago 12. Olivia Mitchell 13. Verónica Montecinos 14. Joakim Palme 15. Ricardo Paredes 16. José Luis Ruiz 17. Jorge Tarzján 18. Sergio Urzúa 19. Andras Uthoff	19
<b>Against</b>	1. Regina Clark 2. Leokadia Oreziak 3. Marcela Ríos 4. Claudia Robles 5. Claudia Sanhueza	5
<b>Abstention</b>		0
<b>TOTAL</b>		24

**Proposal 13: Increase and standardize the ceiling for pension contributions from the current limit (73.2 UF) to the ceiling currently in effect for unemployment insurance (109.8 UF).**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala 2. Orazio Attanasio 3. Nicholas Barr 4. Fabio Bertranou 5. David Bravo 6. Hugo Cifuentes 7. Martín Costabal 8. Carlos Díaz 9. Christian Larraín 10. Costas Meghir 11. Carmelo Mesa-Lago 12. Olivia Mitchell 13. Verónica Montecinos 14. Joakim Palme 15. Ricardo Paredes 16. José Luis Ruiz 17. Jorge Tarzján 18. Sergio Urzúa 19. Andras Uthoff	19
<b>Against</b>	1. Regina Clark 2. Leokadia Oreziak 3. Marcela Ríos 4. Claudia Robles 5. Claudia Sanhueza	5
<b>Abstention</b>		0
<b>TOTAL</b>		24

**Proposal 14: Create a Social Security Division as part of the Labor Department reporting to Office of the Undersecretary of Social Security on all matters related to declarations, contributions, oversight, and collections regarding social security.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala 2. Orazio Attanasio 3. Nicholas Barr 4. Fabio Bertranou 5. David Bravo 6. Regina Clark 7. Martín Costabal 8. Carlos Díaz 9. Christian Larraín 10. Costas Meghir 11. Carmelo Mesa-Lago 12. Olivia Mitchell 13. Verónica Montecinos 14. Leokadia Oreziak 15. Joakim Palme 16. Ricardo Paredes 17. Marcela Ríos 18. Claudia Robles 19. José Luis Ruiz 20. Claudia Sanhueza 21. Jorge Tarzján 22. Sergio Urzúa 23. Andras Uthoff	23
<b>Against</b>		0
<b>Abstention</b>	1. Hugo Cifuentes	1
<b>TOTAL</b>		24

**Proposal 15: Increase the currently low fines payable by employers who withhold funds from workers' incomes and then fail to pass on workers' social security contributions.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala	20
	2. Orazio Attanasio	
	3. Nicholas Barr	
	4. Fabio Bertranou	
	5. David Bravo	
	6. Hugo Cifuentes	
	7. Regina Clark	
	8. Christian Larraín	
	9. Costas Meghir	
	10. Carmelo Mesa-Lago	
	11. Olivia Mitchell	
	12. Verónica Montecinos	
	13. Leokadia Oreziak	
	14. Joakim Palme	
	15. Marcela Ríos	
	16. Claudia Robles	
	17. José Luis Ruiz	
	18. Claudia Sanhueza	
	19. Jorge Tarzján	
	20. Sergio Urzúa	
<b>Against</b>	1. Martín Costabal	2
	2. Ricardo Paredes	
<b>Abstention</b>	1. Carlos Díaz	2
	2. Andras Uthoff	
<b>TOTAL</b>		24

**Proposal 16: Extend the period of compulsory contributions to the age of actual retirement from the labor market. In cases where that age is older than 60 for women and 65 for men.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala	14
	2. Orazio Attanasio	
	3. Nicholas Barr	
	4. Fabio Bertranou	
	5. David Bravo	
	6. Hugo Cifuentes	
	7. Martín Costabal	
	8. Christian Larraín	
	9. Carmelo Mesa-Lago	
	10. Joakim Palme	
	11. Ricardo Paredes	
	12. José Luis Ruiz	
	13. Sergio Urzúa	
	14. Andras Uthoff	
<b>Against</b>	1. Regina Clark	7
	2. Carlos Díaz	
	3. Leokadia Oreziak	
	4. Marcela Ríos	
	5. Claudia Robles	
	6. Claudia Sanhueza	
	7. Jorge Tarzján	
<b>Abstention</b>	1. Costas Meghir	3
	2. Olivia Mitchell	
	3. Verónica Montecinos	
<b>TOTAL</b>		24

**Proposal 17: Introduce changes in APVC (Collective Voluntary Pension Saving) regulations, so as to increase the number of companies and unions that join this voluntary saving mechanism.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala	13
	2. Nicholas Barr	
	3. Fabio Bertranou	
	4. Hugo Cifuentes	
	5. Carlos Díaz	
	6. Verónica Montecinos	
	7. Joakim Palme	
	8. Marcela Ríos	
	9. Claudia Robles	
	10. José Luis Ruiz	
	11. Claudia Sanhueza	
	12. Jorge Tarziján	
	13. Sergio Urzúa	
<b>Against</b>	1. David Bravo	3
	2. Regina Clark	
	3. Ricardo Paredes	
<b>Abstention</b>	1. Orazio Attanasio	8
	2. Martín Costabal	
	3. Christian Larraín	
	4. Costas Meghir	
	5. Carmelo Mesa-Lago	
	6. Olivia Mitchell	
	7. Leokadia Oreziak	
	8. Andras Uthoff	
<b>TOTAL</b>		24

#### 4. Increase the legal retirement age and introduce incentives to work by older persons

**Proposal 18: Match the retirement age of men and women.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala	18
	2. Orazio Attanasio	
	3. Nicholas Barr	
	4. Fabio Bertranou	
	5. David Bravo	
	6. Hugo Cifuentes	
	7. Martín Costabal	
	8. Carlos Díaz	
	9. Christian Larraín	
	10. Costas Meghir	
	11. Carmelo Mesa-Lago	
	12. Olivia Mitchell	
	13. Joakim Palme	
	14. Ricardo Paredes	
	15. José Luis Ruiz	
	16. Jorge Tarzján	
	17. Sergio Urzúa	
	18. Andras Uthoff	
<b>Against</b>	1. Regina Clark	6
	2. Verónica Montecinos	
	3. Marcela Ríos	
	4. Claudia Robles	
	5. Claudia Sanhueza	
	6. Leokadia Oreziak	
<b>Abstention</b>		0
<b>TOTAL</b>		24

**Proposal 19: Periodically review the retirement age.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala	18
	2. Orazio Attanasio	
	3. Nicholas Barr	
	4. Fabio Bertranou	
	5. David Bravo	
	6. Hugo Cifuentes	
	7. Martín Costabal	
	8. Carlos Díaz	
	9. Christian Larraín	
	10. Costas Meghir	
	11. Carmelo Mesa-Lago	
	12. Olivia Mitchell	
	13. Joakim Palme	
	14. Ricardo Paredes	
	15. José Luis Ruiz	
	16. Sergio Urzúa	
	17. Jorge Tarzján	
	18. Andras Uthoff	
<b>Against</b>	1. Regina Clark	5
	2. Leokadia Oreziak	
	3. Marcela Ríos	
	4. Claudia Robles	
	5. Claudia Sanhueza	
<b>Abstention</b>	1. Verónica Montecinos	1
<b>TOTAL</b>		24

**Proposal 20: Incorporate an incentive for those beneficiaries of the Solidarity Pension System who postpone their retirement.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala 2. Orazio Attanasio 3. Nicholas Barr 4. Fabio Bertranou 5. David Bravo 6. Hugo Cifuentes 7. Martín Costabal 8. Carlos Díaz 9. Christian Larraín 10. Costas Meghir 11. Carmelo Mesa-Lago 12. Olivia Mitchell 13. Verónica Montecinos 14. Joakim Palme 15. Ricardo Paredes 16. Claudia Robles 17. José Luis Ruiz 18. Jorge Tarzján 19. Sergio Urzúa 20. Andras Uthoff	20
<b>Against</b>	1. Regina Clark 2. Leokadia Oreziak 3. Marcela Ríos 4. Claudia Sanhueza	4
<b>Abstention</b>		0
<b>TOTAL</b>		24

**Proposal 21: Establish a subsidy to encourage the employment of older people similar to the current Youth Employment Subsidy.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala 2. Orazio Attanasio 3. Nicholas Barr 4. Fabio Bertranou 5. David Bravo 6. Hugo Cifuentes 7. Martín Costabal 8. Carlos Díaz 9. Christian Larraín 10. Costas Meghir 11. Carmelo Mesa-Lago 12. Olivia Mitchell 13. Verónica Montecinos 14. Joakim Palme 15. Ricardo Paredes 16. Marcela Ríos 17. Claudia Robles 18. José Luis Ruiz 19. Claudia Sanhueza 20. Jorge Tarzján 21. Sergio Urzúa 22. Andras Uthoff	22
<b>Against</b>		0
<b>Abstention</b>	1. Regina Clark 2. Leokadia Oreziak	2
<b>TOTAL</b>		24

**Proposal 22: Establish high quality jobs for senior citizens as an objective of labor policy and develop specific programs for this age group.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala	18
	2. Nicholas Barr	
	3. Fabio Bertranou	
	4. David Bravo	
	5. Hugo Cifuentes	
	6. Martín Costabal	
	7. Carlos Díaz	
	8. Christian Larraín	
	9. Carmelo Mesa-Lago	
	10. Olivia Mitchell	
	11. Verónica Montecinos	
	12. Ricardo Paredes	
	13. Marcela Ríos	
	14. José Luis Ruiz	
	15. Jorge Tarzján	
	16. Claudia Sanhueza	
	17. Sergio Urzúa	
	18. Andras Uthoff	
<b>Against</b>	1. Orazio Attanasio	2
	2. Leokadia Oreziak	
<b>Abstention</b>	1. Regina Clark	4
	2. Costas Meghir	
	3. Joakim Palme	
	4. Claudia Robles	
<b>TOTAL</b>		24

**Proposal 23: Delegate relevant decisions regarding the investment regime of the Technical Council on Investments, which will require expanding its powers.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala	14
	2. Nicholas Barr	
	3. David Bravo	
	4. Hugo Cifuentes	
	5. Christian Larraín	
	6. Verónica Montecinos	
	7. Joakim Palme	
	8. Marcela Ríos	
	9. Claudia Robles	
	10. José Luis Ruiz	
	11. Claudia Sanhueza	
	12. Jorge Tarzján	
	13. Sergio Urzúa	
	14. Andras Uthoff	
<b>Against</b>	1. Olivia Mitchell	3
	2. Leokadia Oreziak	
	3. Ricardo Paredes	
<b>Abstention</b>	1. Orazio Attanasio	7
	2. Fabio Bertranou	
	3. Regina Clark	
	4. Martín Costabal	
	5. Carlos Díaz	
	6. Costas Meghir	
	7. Carmelo Mesa-Lago	
<b>TOTAL</b>		24

## 5. Reduce the risk to wich affiliates are exposed

**Proposal 24:** Allow a greater proportion of investment to be made in real assets (alternative assets and investment funds) and find new ways to limit difficulties caused by the absence of continuous market valuation of these assets.

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala 2. Orazio Attanasio 3. Nicholas Barr 4. Fabio Bertranou 5. David Bravo 6. Hugo Cifuentes 7. Martín Costabal 8. Carlos Díaz 9. Christian Larraín 10. Costas Meghir 11. Carmelo Mesa-Lago 12. Joakim Palme 13. Ricardo Paredes 14. José Luis Ruiz 15. Sergio Urzúa 16. Andras Uthoff	16
<b>Against</b>	1. Regina Clark 2. Olivia Mitchell 3. Leokadia Oreziak 4. Marcela Ríos 5. Claudia Robles 6. Claudia Sanhueza	6
<b>Abstention</b>	1. Verónica Montecinos 2. Jorge Tarziján	2
<b>TOTAL</b>		24

**Proposal 25:** Develop new instruments to invest in national production, specifically ones that can benefit small and medium-sized businesses.

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Nicholas Barr 2. Fabio Bertranou 3. Hugo Cifuentes 4. Regina Clark 5. Martín Costabal 6. Christian Larraín 7. Carmelo Mesa-Lago 8. Verónica Montecinos 9. Joakim Palme 10. Marcela Ríos 11. Claudia Robles 12. José Luis Ruiz 13. Claudia Sanhueza 14. Andras Uthoff	14
<b>Against</b>	1. Carlos Díaz 2. Olivia Mitchell 3. Leokadia Oreziak 4. Ricardo Paredes 5. Jorge Tarziján	5
<b>Abstention</b>	1. Cecilia Albala 2. Orazio Attanasio 3. David Bravo 4. Costas Meghir 5. Sergio Urzúa	5
<b>TOTAL</b>		24

**Proposal 26:** In the context of the current five multifunds, restrict access to Fund A.

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala	16
	2. Orazio Attanasio	
	3. Nicholas Barr	
	4. Fabio Bertranou	
	5. David Bravo	
	6. Hugo Cifuentes	
	7. Martín Costabal	
	8. Carlos Díaz	
	9. Christian Larraín	
	10. Carmelo Mesa-Lago	
	11. Leokadia Oreziak	
	12. Marcela Ríos	
	13. Claudia Robles	
	14. José Luis Ruiz	
	15. Claudia Sanhueza	
	16. Andras Uthoff	
<b>Against</b>	1. Regina Clark	4
	2. Olivia Mitchell	
	3. Verónica Montecinos	
	4. Ricardo Paredes	
<b>Abstention</b>	1. Costas Meghir	4
	2. Joakim Palme	
	3. Jorge Tarzján	
	4. Sergio Urzúa	
<b>TOTAL</b>		<b>24</b>

**Proposal 27:** In the context of the current five multifunds, reduce the maximum risk exposure of workers' pensions savings, beginning when they are 20 years from the retirement age.

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala	13
	2. Nicholas Barr	
	3. Fabio Bertranou	
	4. David Bravo	
	5. Hugo Cifuentes	
	6. Martín Costabal	
	7. Christian Larraín	
	8. Carmelo Mesa-Lago	
	9. Marcela Ríos	
	10. Claudia Robles	
	11. Claudia Sanhueza	
	12. Jorge Tarzján	
	13. Andras Uthoff	
<b>Against</b>	1. Regina Clark	6
	2. Olivia Mitchell	
	3. Verónica Montecinos	
	4. Leokadia Oreziak	
	5. Ricardo Paredes	
	6. José Luis Ruiz	
<b>Abstention</b>	1. Orazio Attanasio	5
	2. Carlos Díaz	
	3. Costas Meghir	
	4. Joakim Palme	
	5. Sergio Urzúa	
<b>TOTAL</b>		<b>24</b>

**Proposal 28: Decrease the number of multifunds from 5 to 3 (eliminating Funds A and E).**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala	14
	2. Nicholas Barr	
	3. David Bravo	
	4. Regina Clark	
	5. Martín Costabal	
	6. Carlos Díaz	
	7. Carmelo Mesa-Lago	
	8. Olivia Mitchell	
	9. Joakim Palme	
	10. Marcela Ríos	
	11. Claudia Robles	
	12. José Luis Ruiz	
	13. Claudia Sanhueza	
	14. Sergio Urzúa	
<b>Against</b>	1. Orazio Attanasio	4
	2. Leokadia Oreziak	
	3. Ricardo Paredes	
	4. Jorge Tarzján	
<b>Abstention</b>	1. Fabio Bertranou	6
	2. Hugo Cifuentes	
	3. Christian Larraín	
	4. Costas Meghir	
	5. Verónica Montecinos	
	6. Andras Uthoff	
<b>TOTAL</b>		24

## 6. Increase competition in the AFP market

**Proposal 29: Extend the current bidding process that covers all new affiliates to include some existing affiliates, using a mechanism to be defined.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala 2. Orazio Attanasio 3. Nicholas Barr 4. Fabio Bertranou 5. David Bravo 6. Hugo Cifuentes 7. Martín Costabal 8. Carlos Díaz 9. Christian Larraín 10. Costas Meghir 11. Carmelo Mesa-Lago 12. Olivia Mitchell 13. Joakim Palme 14. Ricardo Paredes 15. Marcela Ríos 16. Claudia Robles 17. José Luis Ruiz 18. Claudia Sanhueza 19. Jorge Tarzján 20. Sergio Urzúa 21. Andras Uthoff	21
<b>Against</b>	1. Regina Clark 2. Verónica Montecinos 3. Leokadia Oreziak	3
<b>Abstention</b>		0
<b>TOTAL</b>		24

**Proposal 30: Require AFPs, rather than affiliates, to absorb brokerage fees.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Fabio Bertranou 2. Hugo Cifuentes 3. Regina Clark 4. Christian Larraín 5. Carmelo Mesa-Lago 6. Verónica Montecinos 7. Joakim Palme 8. Marcela Ríos 9. Claudia Robles 10. José Luis Ruiz 11. Claudia Sanhueza 12. Leokadia Oreziak 13. Andras Uthoff	13
<b>Against</b>	1. Orazio Attanasio 2. David Bravo 3. Martín Costabal 4. Costas Meghir 5. Olivia Mitchell 6. Ricardo Paredes 7. Sergio Urzúa	7
<b>Abstention</b>	1. Cecilia Albala 2. Nicholas Barr 3. Carlos Díaz 4. Jorge Tarzján	4
<b>TOTAL</b>		24

**Proposal 31: Create a state AFP which will compete on an even playing field with the other AFPs, in conformity with the legislative proposal before Congress.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala 2. Orazio Attanasio 3. Nicholas Barr 4. Fabio Bertranou 5. David Bravo 6. Hugo Cifuentes 7. Regina Clark 8. Martín Costabal 9. Carlos Díaz 10. Christian Larraín 11. Costas Meghir 12. Carmelo Mesa-Lago 13. Olivia Mitchell 14. Verónica Montecinos 15. Joakim Palme 16. Ricardo Paredes 17. Marcela Ríos 18. Claudia Robles 19. Claudia Sanhueza 20. Jorge Tarzján 21. Andras Uthoff	21
<b>Against</b>	1. Leokadia Oreziak 2. José Luis Ruiz	2
<b>Abstention</b>	1. Sergio Urzúa	1
<b>TOTAL</b>		24

**Proposal 32: Allow non-profit entities whose sole purpose is to manage pension funds to enter the pension fund industry.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala 2. Orazio Attanasio 3. Nicholas Barr 4. Fabio Bertranou 5. David Bravo 6. Hugo Cifuentes 7. Regina Clark 8. Carlos Díaz 9. Christian Larraín 10. Carmelo Mesa-Lago 11. Olivia Mitchell 12. Verónica Montecinos 13. Joakim Palme 14. Ricardo Paredes 15. Marcela Ríos 16. Claudia Robles 17. José Luis Ruiz 18. Claudia Sanhueza 19. Jorge Tarzján 20. Sergio Urzúa 21. Andras Uthoff	21
<b>Against</b>	1. Leokadia Oreziak	1
<b>Abstention</b>	1. Martín Costabal 2. Costas Meghir	2
<b>TOTAL</b>		24

## 7. Reduce the gender gap

**Proposal 33: Eliminate usage of sex-differentiated mortality tables.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala 2. Orazio Attanasio 3. Nicholas Barr 4. Fabio Bertranou 5. David Bravo 6. Hugo Cifuentes 7. Regina Clark 8. Martín Costabal 9. Carlos Díaz 10. Christian Larraín 11. Costas Meghir 12. Carmelo Mesa-Lago 13. Olivia Mitchell 14. Verónica Montecinos 15. Joakim Palme 16. Ricardo Paredes 17. Marcela Ríos 18. Claudia Robles 19. José Luis Ruiz 20. Claudia Sanhueza 21. Jorge Tarzján 22. Sergio Urzúa 23. Andras Uthoff	23
<b>Against</b>		0
<b>Abstention</b>	1. Leokadia Oreziak	1
<b>TOTAL</b>		24

**Proposal 34: Establish that in the case of divorce, the division of pension funds, if considered by a judge, should be in equal parts.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala 2. Orazio Attanasio 3. Nicholas Barr 4. Fabio Bertranou 5. David Bravo 6. Regina Clark 7. Carlos Díaz 8. Olivia Mitchell 9. Costas Meghir 10. Carmelo Mesa-Lago 11. Verónica Montecinos 12. Marcela Ríos 13. Claudia Robles 14. José Luis Ruiz 15. Claudia Sanhueza 16. Jorge Tarzján 17. Sergio Urzúa	17
<b>Against</b>	1. Joakim Palme	1
<b>Abstention</b>	1. Hugo Cifuentes 2. Martín Costabal 3. Christian Larraín 4. Leokadia Oreziak 5. Ricardo Paredes 6. Andras Uthoff	6
<b>TOTAL</b>		24

**Proposal 35: Establish shared pension funds. We propose that 50% of the mandatory pension contribution be deposited in the individual account of the spouse or partner in a relationship of a cohabitation.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Orazio Attanasio 2. Nicholas Barr 3. Fabio Bertranou 4. David Bravo 5. Regina Clark 6. Carlos Díaz 7. Costas Meghir 8. Carmelo Mesa-Lago 9. Olivia Mitchell 10. Verónica Montecinos 11. Claudia Robles 12. Jorge Tarziján 13. Sergio Urzúa	13
<b>Against</b>	1. Joakim Palme 2. Marcela Ríos 3. Claudia Sanhueza	3
<b>Abstention</b>	1. Cecilia Albala 2. Hugo Cifuentes 3. Martín Costabal 4. Christian Larraín 5. Ricardo Paredes 6. José Luis Ruiz 7. Leokadia Oreziak 8. Andras Uthoff	8
<b>TOTAL</b>		24

**Proposal 36: Establish a social security compensation for caregivers.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala 2. Orazio Attanasio 3. Nicholas Barr 4. Fabio Bertranou 5. David Bravo 6. Hugo Cifuentes 7. Regina Clark 8. Martín Costabal 9. Carlos Díaz 10. Christian Larraín 11. Costas Meghir 12. Carmelo Mesa-Lago 13. Verónica Montecinos 14. Ricardo Paredes 15. Claudia Sanhueza 16. Marcela Ríos 17. Claudia Robles 18. José Luis Ruiz 19. Jorge Tarziján 20. Sergio Urzúa 21. Andras Uthoff	21
<b>Against</b>	1. Olivia Mitchell	1
<b>Abstention</b>	1. Joakim Palme 2. Leokadia Oreziak	2
<b>TOTAL</b>		24

**Proposal 37: Increase the coverage of quality early education, helping women to enter the workforce.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala	14
	2. Fabio Bertranou	
	3. David Bravo	
	4. Hugo Cifuentes	
	5. Regina Clark	
	6. Martín Costabal	
	7. Carmelo Mesa-Lago	
	8. Verónica Montecinos	
	9. Leokadia Oreziak	
	10. Marcela Ríos	
	11. Claudia Robles	
	12. José Luis Ruiz	
	13. Claudia Sanhueza	
	14. Andras Uthoff	
<b>Against</b>	1. Olivia Mitchell	3
	2. Ricardo Paredes	
	3. Sergio Urzúa	
<b>Abstention</b>	1. Orazio Attanasio	7
	2. Nicholas Barr	
	3. Carlos Díaz	
	4. Christian Larraín	
	5. Costas Meghir	
	6. Joakim Palme	
	7. Jorge Tarziján	
<b>TOTAL</b>		24

## 8. Expand and integrate public policies for older people

**Proposal 38: Create a Comprehensive Protection System for Older People.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala 2. Nicholas Barr 3. Fabio Bertranou 4. David Bravo 5. Hugo Cifuentes 6. Regina Clark 7. Martín Costabal 8. Carlos Díaz 9. Christian Larraín 10. Carmelo Mesa-Lago 11. Verónica Montecinos 12. Leokadia Oreziak 13. Joakim Palme 14. Ricardo Paredes 15. Marcela Ríos 16. Claudia Robles 17. José Luis Ruiz 18. Claudia Sanhueza 19. Jorge Tarzján 20. Sergio Urzúa 21. Andras Uthoff	21
<b>Against</b>	1. Olivia Mitchell	1
<b>Abstention</b>	1. Orazio Attanasio 2. Costas Meghir	2
<b>TOTAL</b>		24

**Proposal 39: Create and implement a dependency law.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala 2. Nicholas Barr 3. Fabio Bertranou 4. David Bravo 5. Hugo Cifuentes 6. Regina Clark 7. Christian Larraín 8. Carmelo Mesa-Lago 9. Verónica Montecinos 10. Marcela Ríos 11. Claudia Robles 12. Claudia Sanhueza 13. Andras Uthoff	13
<b>Against</b>	1. Martín Costabal 2. Olivia Mitchell 3. Leokadia Oreziak 4. Ricardo Paredes	4
<b>Abstention</b>	1. Orazio Attanasio 2. Carlos Díaz 3. Costas Meghir 4. Joakim Palme 5. Jorge Tarzján 6. José Luis Ruiz 7. Sergio Urzúa	7
<b>TOTAL</b>		24

**Proposal 40: Promote the creation of day centres.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala	16
	2. Nicholas Barr	
	3. Fabio Bertranou	
	4. David Bravo	
	5. Hugo Cifuentes	
	6. Regina Clark	
	7. Martín Costabal	
	8. Carlos Díaz	
	9. Verónica Montecinos	
	10. Leokadia Oreziak	
	11. Marcela Ríos	
	12. Claudia Robles	
	13. Claudia Sanhueza	
	14. Jorge Tarzján	
	15. Sergio Urzúa	
	16. Andras Uthoff	
<b>Against</b>	1. Carmelo Mesa-Lago	3
	2. Olivia Mitchell	
	3. Ricardo Paredes	
<b>Abstention</b>	1. Orazio Attanasio	5
	2. Christian Larrain	
	3. Costas Meghir	
	4. Joakim Palme	
	5. José Luis Ruiz	
<b>TOTAL</b>		<b>24</b>

## 9. Improve social security institutions, promote social participation and welfare education

**Proposal 41: Strengthen and broaden the scope of the powers of the Advisory Council on Social Security (Consejo Consultivo Previsional).**

**Proposal 42: Review the constitution, powers, functions, sustainability, and integration of the current Users' Commission.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala 2. Nicholas Barr 3. Fabio Bertranou 4. David Bravo 5. Hugo Cifuentes 6. Regina Clark 7. Martín Costabal 8. Carlos Díaz 9. Christian Larraín 10. Costas Meghir 11. Carmelo Mesa-Lago 12. Olivia Mitchell 13. Verónica Montecinos 14. Joakim Palme 15. Ricardo Paredes 16. Marcela Ríos 17. Claudia Robles 18. José Luis Ruiz 19. Claudia Sanhueza 20. Jorge Tarziján 21. Sergio Urzúa 22. Andras Uthoff	22
<b>Against</b>		0
<b>Abstention</b>	1. Orazio Attanasio 2. Leokadia Oreziak	2
<b>TOTAL</b>		24

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala 2. Fabio Bertranou 3. David Bravo 4. Hugo Cifuentes 5. Regina Clark 6. Martín Costabal 7. Carlos Díaz 8. Christian Larraín 9. Carmelo Mesa-Lago 10. Verónica Montecinos 11. Leokadia Oreziak 12. Joakim Palme 13. Marcela Ríos 14. Claudia Robles 15. José Luis Ruiz 16. Claudia Sanhueza 17. Jorge Tarziján 18. Sergio Urzúa 19. Andras Uthoff	19
<b>Against</b>	1. Ricardo Paredes	1
<b>Abstention</b>	1. Orazio Attanasio 2. Nicholas Barr 3. Costas Meghir 4. Olivia Mitchell	4
<b>TOTAL</b>		24

**Proposal 43: Strengthen the Institute for Social Security (Instituto de Previsión Social).**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala 2. Nicholas Barr 3. Fabio Bertranou 4. David Bravo 5. Hugo Cifuentes 6. Regina Clark 7. Martín Costabal 8. Christian Larraín 9. Costas Meghir 10. Carmelo Mesa-Lago 11. Olivia Mitchell 12. Verónica Montecinos 13. Leokadia Oreziak 14. Joakim Palme 15. Ricardo Paredes 16. Marcela Ríos 17. Claudia Robles 18. José Luis Ruiz 19. Claudia Sanhueza 20. Sergio Urzúa 21. Andras Uthoff	21
<b>Against</b>		0
<b>Abstention</b>	1. Orazio Attanasio 2. Carlos Díaz 3. Jorge Tarzján	3
<b>TOTAL</b>		24

**Proposal 44: Convert the Superintendence of Pensions to a Pensions and Insurance Commission.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala 2. Nicholas Barr 3. Fabio Bertranou 4. David Bravo 5. Martín Costabal 6. Carlos Díaz 7. Christian Larraín 8. Costas Meghir 9. Carmelo Mesa-Lago 10. Olivia Mitchell 11. Verónica Montecinos 12. Joakim Palme 13. Ricardo Paredes 14. Marcela Ríos 15. Claudia Robles 16. José Luis Ruiz 17. Claudia Sanhueza 18. Jorge Tarzján 19. Sergio Urzúa 20. Andras Uthoff	20
<b>Against</b>	1. Hugo Cifuentes 2. Regina Clark 3. Leokadia Oreziak	3
<b>Abstention</b>	1. Orazio Attanasio	1
<b>TOTAL</b>		24

**Proposal 45: Develop social security education programmes.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala	22
	2. Orazio Attanasio	
	3. Nicholas Barr	
	4. Fabio Bertranou	
	5. David Bravo	
	6. Hugo Cifuentes	
	7. Regina Clark	
	8. Martín Costabal	
	9. Carlos Díaz	
	10. Christian Larraín	
	11. Costas Meghir	
	12. Carmelo Mesa-Lago	
	13. Olivia Mitchell	
	14. Verónica Montecinos	
	15. Joakim Palme	
	16. Marcela Ríos	
	17. Claudia Robles	
	18. José Luis Ruiz	
	19. Claudia Sanhueza	
	20. Jorge Tarzján	
	21. Sergio Urzúa	
	22. Andras Uthoff	
<b>Against</b>	1. Leokadia Oreziak	2
	2. Ricardo Paredes	
<b>Abstention</b>		0
<b>TOTAL</b>		24

**Proposal 46: Establish that Pension Fund Administrators (AFPs) must maintain welfare education programs.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala	17
	2. Orazio Attanasio	
	3. Nicholas Barr	
	4. Fabio Bertranou	
	5. David Bravo	
	6. Hugo Cifuentes	
	7. Martín Costabal	
	8. Carlos Díaz	
	9. Christian Larraín	
	10. Costas Meghir	
	11. Carmelo Mesa-Lago	
	12. Joakim Palme	
	13. Ricardo Paredes	
	14. José Luis Ruiz	
	15. Jorge Tarzján	
	16. Sergio Urzúa	
	17. Andras Uthoff	
<b>Against</b>	1. Regina Clark	6
	2. Verónica Montecinos	
	3. Leokadia Oreziak	
	4. Marcela Ríos	
	5. Claudia Robles	
	6. Claudia Sanhueza	
<b>Abstention</b>	1. Olivia Mitchell	1
<b>TOTAL</b>		24

**Proposal 47: Identify and implement strategic objectives, goals and indicators for the program and for the achievements associated with the Welfare Education Fund (Fondo de Educación Previsional, FEP).**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala 2. Nicholas Barr 3. Fabio Bertranou 4. David Bravo 5. Hugo Cifuentes 6. Regina Clark 7. Martín Costabal 8. Carlos Díaz 9. Christian Larraín 10. Costas Meghir 11. Carmelo Mesa-Lago 12. Olivia Mitchell 13. Verónica Montecinos 14. Joakim Palme 15. Ricardo Paredes 16. Marcela Ríos 17. Claudia Robles 18. José Luis Ruiz 19. Claudia Sanhueza 20. Jorge Tarzijan 21. Sergio Urzúa 22. Andras Uthoff	22
<b>Against</b>	1. Leokadia Oreziak	1
<b>Abstention</b>	1. Orazio Attanasio	1
<b>TOTAL</b>		24

**Proposal 48: Transform the current FEP into a resource fund for pilot intervention programmes.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala 2. Orazio Attanasio 3. Nicholas Barr 4. Fabio Bertranou 5. David Bravo 6. Hugo Cifuentes 7. Martín Costabal 8. Costas Meghir 9. Carmelo Mesa-Lago 10. Olivia Mitchell 11. Verónica Montecinos 12. Joakim Palme 13. Ricardo Paredes 14. Marcela Ríos 15. Claudia Robles 16. José Luis Ruiz 17. Claudia Sanhueza 18. Sergio Urzúa 19. Andras Uthoff	19
<b>Against</b>		0
<b>Abstention</b>	1. Regina Clark 2. Carlos Díaz 3. Christian Larraín 4. Leokadia Oreziak 5. Jorge Tarzijan	5
<b>TOTAL</b>		24

## 10. Reduce uncertainty regarding benefits

**Proposal 49: Eliminate programmed withdrawal pensions.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala 2. Orazio Attanasio 3. Nicholas Barr 4. Fabio Bertranou 5. David Bravo 6. Hugo Cifuentes 7. Regina Clark 8. Carlos Díaz 9. Christian Larraín 10. Costas Meghir 11. Carmelo Mesa-Lago 12. Olivia Mitchell 13. Verónica Montecinos 14. Joakim Palme 15. Ricardo Paredes 16. Claudia Robles 17. Marcela Ríos 18. José Luis Ruiz 19. Claudia Sanhueza 20. Jorge Tarzján 21. Sergio Urzúa 22. Andras Uthoff	22
<b>Against</b>	1. Martín Costabal	1
<b>Abstention</b>	1. Leokadia Oreziak	1
<b>TOTAL</b>		24

**Proposal 50: Restructure the current system for Consultation and Offers of Pension Amounts (SCOMP), to allow for a bidding process for offers for annuities.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala 2. Nicholas Barr 3. Fabio Bertranou 4. David Bravo 5. Hugo Cifuentes 6. Martín Costabal 7. Carlos Díaz 8. Christian Larraín 9. Carmelo Mesa-Lago 10. Olivia Mitchell 11. Ricardo Paredes 12. Marcela Ríos 13. Claudia Robles 14. José Luis Ruiz 15. Claudia Sanhueza 16. Jorge Tarzján 17. Sergio Urzúa 18. Andras Uthoff	18
<b>Against</b>		0
<b>Abstention</b>	1. Orazio Attanasio 2. Regina Clark 3. Costas Meghir 4. Verónica Montecinos 5. Joakim Palme 6. Leokadia Oreziak	6
<b>TOTAL</b>		24

**Proposal 51: Modernize insurance company regulation by converting it into a risk-based capital system.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. David Bravo 2. Hugo Cifuentes 3. Martín Costabal 4. Christian Larraín 5. Olivia Mitchell 6. Joakim Palme 7. Ricardo Paredes 8. Marcela Ríos 9. Claudia Robles 10. José Luis Ruiz 11. Claudia Sanhueza 12. Jorge Tarzján 13. Sergio Urzúa 14. Andras Uthoff	14
<b>Against</b>		0
<b>Abstention</b>	1. Cecilia Albala 2. Orazio Attanasio 3. Nicholas Barr 4. Fabio Bertranou 5. Regina Clark 6. Carlos Díaz 7. Costas Meghir 8. Carmelo Mesa-Lago 9. Verónica Montecinos 10. Leokadia Oreziak	10
<b>TOTAL</b>		24

**Proposal 52: Evaluate the use of life expectancy tables differentiated by educational level or average income.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala 2. Orazio Attanasio 3. Nicholas Barr 4. David Bravo 5. Martín Costabal 6. Carlos Díaz 7. Costas Meghir 8. Verónica Montecinos 9. Marcela Ríos 10. Claudia Robles 11. José Luis Ruiz 12. Claudia Sanhueza 13. Jorge Tarzján 14. Sergio Urzúa	14
<b>Against</b>	1. Hugo Cifuentes 2. Christian Larraín 3. Olivia Mitchell 4. Ricardo Paredes 5. Andras Uthoff	5
<b>Abstention</b>	1. Fabio Bertranou 2. Regina Clark 3. Carmelo Mesa-Lago 4. Leokadia Oreziak 5. Joakim Palme	5
<b>TOTAL</b>		24

**Proposal 53: Review current mortality tables, aligning them with life expectancy, as published by the INE.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala	18
	2. Nicholas Barr	
	3. Fabio Bertranou	
	4. David Bravo	
	5. Hugo Cifuentes	
	6. Carlos Díaz	
	7. Regina Clark	
	8. Christian Larraín	
	9. Olivia Mitchell	
	10. Verónica Montecinos	
	11. Joakim Palme	
	12. Marcela Ríos	
	13. Claudia Robles	
	14. José Luis Ruiz	
	15. Claudia Sanhueza	
	16. Jorge Tarzján	
	17. Sergio Urzúa	
	18. Andras Uthoff	
<b>Against</b>	1. Ricardo Paredes	1
<b>Abstention</b>	1. Orazio Attanasio	5
	2. Martín Costabal	
	3. Costas Meghir	
	4. Carmelo Mesa-Lago	
	5. Leokadia Oreziak	
<b>TOTAL</b>		24

## 11. Safeguard and standardize social security rights

**Proposal 54:** Repeal the wording of Article 12 of Decree Law 3.500 that makes for those with disability benefit incompatible with the old age pension, ensuring that the amount of the disability does not decrease when an affiliate access their old age pension.

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala 2. Fabio Bertranou 3. David Bravo 4. Hugo Cifuentes 5. Regina Clark 6. Christian Larraín 7. Carmelo Mesa-Lago 8. Verónica Montecinos 9. Marcela Ríos 10. Claudia Robles 11. José Luis Ruiz 12. Claudia Sanhueza 13. Leokadia Oreziak 14. Andras Uthoff	14
<b>Against</b>	1. Olivia Mitchell 2. Ricardo Paredes	2
<b>Abstention</b>	1. Orazio Attanasio 2. Nicholas Barr 3. Martín Costabal 4. Carlos Díaz 5. Costas Meghir 6. Joakim Palme 7. Jorge Tarzján 8. Sergio Urzúa	8
<b>TOTAL</b>		24

**Proposal 55:** Review qualification mechanisms, standardizing disability percentages, procedures, and the institutions empowered to classify cases in the two systems.

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala 2. Fabio Bertranou 3. Hugo Cifuentes 4. Regina Clark 5. Martín Costabal 6. Carlos Díaz 7. Christian Larraín 8. Carmelo Mesa-Lago 9. Verónica Montecinos 10. Leokadia Oreziak 11. Marcela Ríos 12. Claudia Robles 13. José Luis Ruiz 14. Claudia Sanhueza 15. Jorge Tarzján 16. Sergio Urzúa 17. Andras Uthoff	17
<b>Against</b>	1. Ricardo Paredes	1
<b>Abstention</b>	1. Orazio Attanasio 2. Nicholas Barr 3. David Bravo 4. Costas Meghir 5. Olivia Mitchell 6. Joakim Palme	6
<b>TOTAL</b>		24

**Proposal 56: Increase the contributions paid by workers and their employers for heavy work and moderately heavy work.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Fabio Bertranou	16
	2. Hugo Cifuentes	
	1. Regina Clark	
	3. Martín Costabal	
	4. Carlos Díaz	
	5. Christian Larraín	
	6. Carmelo Mesa-Lago	
	7. Verónica Montecinos	
	8. Leokadia Oreziak	
	9. Joakim Palme	
	10. Marcela Ríos	
	11. Claudia Robles	
	12. José Luis Ruiz	
	13. Claudia Sanhueza	
	14. Jorge Tarzján	
15. Andras Uthoff		
<b>Against</b>	1. David Bravo	3
	2. Olivia Mitchell	
	3. Ricardo Paredes	
<b>Abstention</b>	1. Cecilia Albala	5
	2. Orazio Attanasio	
	3. Nicholas Barr	
	4. Costas Meghir	
	5. Sergio Urzúa	
<b>TOTAL</b>		<b>24</b>

**Proposal 57: Establish that the benefits received under Laws 19.123 and 19.980 (the Rettig Laws), Law 19.234 (Exonerated Political Prisoners Law), and 19.992 of 2004 (Valech Law) should be classified as reparations -not as pension benefits-, thereby improving beneficiaries' access to solidarity benefits.**

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala	17
	2. Nicholas Barr	
	3. Fabio Bertranou	
	4. David Bravo	
	5. Regina Clark	
	6. Christian Larraín	
	7. Carmelo Mesa-Lago	
	8. Verónica Montecinos	
	9. Joakim Palme	
	10. Ricardo Paredes	
	11. Marcela Ríos	
	12. Claudia Robles	
	13. José Luis Ruiz	
	14. Claudia Sanhueza	
	15. Jorge Tarzján	
	16. Sergio Urzúa	
	17. Andras Uthoff	
<b>Against</b>	1. Olivia Mitchell	1
<b>Abstention</b>	1. Orazio Attanasio	6
	2. Hugo Cifuentes	
	3. Martín Costabal	
	4. Carlos Díaz	
	5. Costas Meghir	
	6. Leokadia Oreziak	
<b>TOTAL</b>		<b>24</b>

**Proposal 58:** *Although the mandate of the Commission refers to Decree Law 3.500 and Law 20.255 (on the civilian pensions system), the Commission considers that the Armed Forces, Carabineros and similar bodies should, in general, receive the same treatment regarding affiliation and contributions as other workers, in accordance with the specific characteristics of their occupation.*

TYPE OF VOTE	COMMISSIONERS	TOTAL
<b>In Favor</b>	1. Cecilia Albala 2. Orazio Attanasio 3. Nicholas Barr 4. Fabio Bertranou 5. David Bravo 6. Hugo Cifuentes 7. Regina Clark 8. Martín Costabal 9. Carlos Díaz 10. Christian Larraín 11. Costas Meghir 12. Carmelo Mesa-Lago 13. Olivia Mitchell 14. Verónica Montencinos 15. Joakim Palme 16. Ricardo Paredes 17. Marcela Ríos 18. Claudia Robles 19. José Luis Ruiz 20. Claudia Sanhueza 21. Jorge Tarzizán 22. Sergio Urzúa 23. Andras Uthoff	23
<b>Against</b>	1. Leokadia Oreziak	1
<b>Abstention</b>		0
<b>TOTAL</b>		24

## Appendix No. 6: Arguments from the minority votes

### Reservation referring to proposal 9, “Establish a new pension contribution, to be paid by the employer, of 4%.”

My vote “against” this proposal is based on the potential impact of a 4% increase in the contribution (from 10% to 14%) on the labor market. Without accurate technical studies on the effect of this change on, for example, the level formality of the labor market, it seems unwise to wager on such a high initial increase. As discussed in the context of global proposal A, an increase of 2% or 3% would seem to be a more appropriate starting point. A contribution rate that is excessive could increase rates of informality, deepen contribution gaps and, ultimately, it could have counterproductive effects on precisely the people that we seek to benefit. Because of the risk, and recognizing the need for increased contributions, I think reducing the increase to something less than 4% would be more appropriate.

Submitted by Sergio Urzúa

### Reservation referring to proposal 18, “Matching the retirement ages of men and women”

The assessment prepared by the Commission, like the evidence that has emerged from national and international studies, shows that in Chile the labor market is highly segmented in terms of gender. Women's participation is more precarious, and they are segregated in sectors and occupations with lower pay and greater informality, which widens the gender gap between their earnings and the income earned by men. The assessment also notes that although the pension reform of 2008 introduced significant changes to reduce gender inequality, the level of gender inequality in pensions this is still acute. Women still receive, on average, much lower pensions than men do in the AFP pension system, and women represent most of those who receive solidarity pensions funded by the state, a compensatory mechanism that seeks to reduce poverty among the elderly.

The available data reveals the double burden faced by women who are in paid or unpaid caregiving roles, which has repercussions for their health as they reach adulthood. Additionally, it should be considered that women are the primary caregivers of dependents, and that this dynamic intensifies when caregiving for is required for children or for an elderly person.

This persistent inequality is primarily a result of a series of cultural and social messages that portray women as people who do not have the same rights and freedoms as men do in society. This, in turn, strongly determines the choices that they make throughout their lives in education, the labor market, investment, and their reproductive lives, among others. Second, inequalities are reproduced by the very foundations of the country's system of social protection, which clearly differentiates between the roles that women and men are expected to play. The system gives women responsibility for reproduction and caregiving (assuming that their economically productive role will be secondary) and giving men responsibility for economically productive activities (exempting them from responsibility in reproduction and caregiving). Currently the bulk of the rules and incentives that regulate the labor market reinforce this sexual division of labor (examples: Article 203 of nurseries, the compulsory postnatal period only for women, permission only for women to care for a sick child under one years old, permission for feeding). Something similar happens with the way that most social programs are designed and are implemented in practice. In short, the State actively reproduces and strengthens the inequalities of the labor market and the pension system.

We agree on the importance of considering demographic changes to increase the retirement age in the future, and consider it appropriate to apply this measure (standardizing the same retirement age for men and women) to cohorts of women who have not yet made their choices about their

reproductive, educational, and employment paths. We reject the idea of equalizing the retirement age between men and women in the current framework of social protection in the country, so as not to harm current generations by changing the rules. We disagree with implementing this measure now because equalizing the retirement age for men and women is based on the wrong assumption that there is equality between the sexes in the underlying labor conditions.

In our view: (1) we cannot equalize the retirement age for men and women without taking prior actions that would generate greater equality in the distribution of reproductive and economically productive work in different spheres of life, such as in the division of labor in caring for the family or in the labor market; (2) the equalization cannot occur before the individual capitalization pillar of the current pension system has undergone structural reforms. This requires introducing solidarity mechanisms for collectively sharing the costs and rewards of reproductive work and caregiving, and breaking the segmentation in the pension system that generates first and second categories, the latter of which is accessed mainly by women.

In order to move towards real gender equality in the pension system, in the Commission, we have supported the need for a structural transformation of the pension system to one that is based on universal rights and on the principles of social protection and solidarity.

Submitted by Marcela Ríos, Regina Clark, Verónica Montecinos, Leokadia Oreziak, Claudia Robles, Claudia Sanhueza

### **Reservation referring to Section 7 “Specific Proposals”, points 7.2, 7.3 y 7.4**

No parametric reform that increases the individual capitalization pillar or pension savings and the resulting profits of the AFPs should be implemented without a structural change in the Chilean pension system that gradually includes the logic of social security, as does the global proposal B. Before this change is made, we oppose increasing the retirement age, increasing contribution limits, increasing the coverage of the individual capitalization system via the incorporation of self-employed workers and increasing contributions to the AFPs.

Submitted by Regina Clark, Verónica Montecinos, Marcela Ríos, Claudia Robles, Claudia Sanhueza

### **Reservation referring to proposal 31 “Create a state AFP that will compete on an even playing field with the other AFPs, in conformity with the legislative proposal that is currently before Congress.”**

My “abstention” from this proposal is because I have received insufficient assurance that the state AFP will compete under exactly the same conditions as the private AFP. While the text addresses the need to ensure equal treatment between the institutions, I believe that there are insufficient guarantees in the text for this to occur in practice.

Submitted by Sergio Urzúa

The creation of a State AFP will not eliminate the major shortcomings of the current pension system: pension contributions will go to the financial markets, and not to finance current pensions. Even if the State administers the AFP at “zero cost”, it will not be able to significantly increase pensions. Replacement rates of self-financed pensions will remain low (below 30%) for the coming decades, forcing the government to increase contributory pensions and the number of non-contributory pensions with monetary subsidies that are currently already very high.

Submitted by Leokadia Oreziak

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## **Reservation referring to proposal 50 “Restructure the current system of Consultation and Offers of Pension Amounts (SCOMP), allowing for a group bidding process for annuities”**

With respect to the elimination of the programmed withdrawal mechanism, we should consider incorporating a mechanism to provide affiliates with greater choice and better guarantees than what is offered by the current system based on the insurance market. In that sense, we believe that is necessary to have a public institution that provides annuities under known rules, reducing the uncertainty of the pension that the affiliate will obtain and the asymmetry of information.

Submitted by Regina Clark, Verónica Montecinos, Marcela Ríos, Claudia Robles, Claudia Sanhueza

## **Reservation referring to the formulation of specific proposals**

The Commissioners listed below support incorporating specific improvements to the current operation of the pension system, but only to the extent that these specific improvements represent progressive and gradual progress towards structural transformation of the system itself, a process which requires a debate among citizens. This position comes from the belief that improvements of the existing system are insufficient to resolve the problems identified in the Commission's assessment with respect to the low pensions that are delivered to most people. Moreover, we see this type of citizen debate as inevitable given that the majority of the public has expressed, through public hearings, dialogues and the survey on opinions, an extreme mistrust of the individual capitalization pillar under the current scheme and even of reforms if they are limited only to improving this pillar.

In this context, we believe that it is imperative to understand that the consideration of specific proposals is a first step in the broader discussion of a structural change of the system of the type outlined in Global Proposal B described in this report.

We have a firm conviction that the public role of the State in the management and operational guarantee of the Chilean pension system must be strengthened, as is consistent with the principles of social security. In this context, we encourage efforts that progressively extend the social security component, and even support leaving it up to the affiliates whether to choose to put their funds in the individual capitalization account or in the social security component. This vision of the State's role is also consistent with the proposal to centralize the functions of affiliation and administration of pension contributions (functions that are currently carried out by the AFPs) in a single public institution, limiting the role of AFPs only to the management of fund investments.

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