

Pension Reforms in Latam: Balance and Challenges Ahead

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The book

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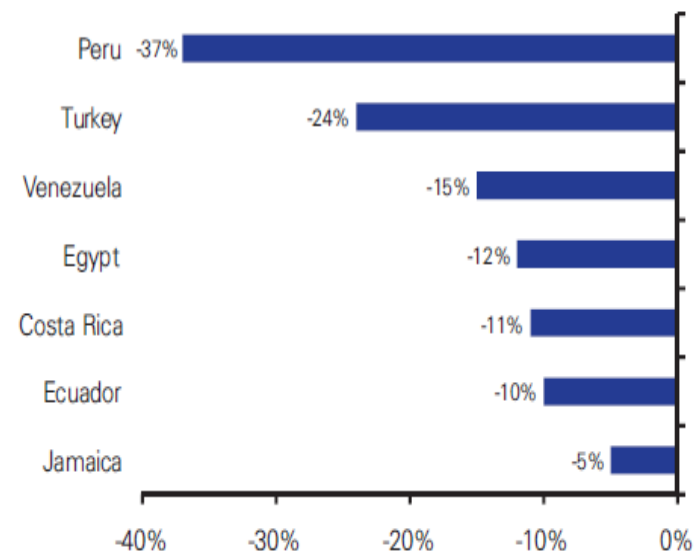
PAYG schemes that could not go alone

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Section II: Where
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- High benefits
- Low contributions
- Financially unsustainable
- No relation btw contrib./pensions
- High evasion in private and public sect.
- Unrealistic pension parameters (retirement age, years of contribution, contribution rate, etc)
- Low and negative financial returns
- Pension funds were spent for other government activities.
- High administrative costs

CHART 1.1: Real returns on some public pension plans in the 1980s



Source: Averting the Old-Age Crisis: Policies to Protect the Old and Promote Growth. New York. Oxford University. World Bank (1994)

From: Escriva, García Herrero y Fuentes, Chapter 1

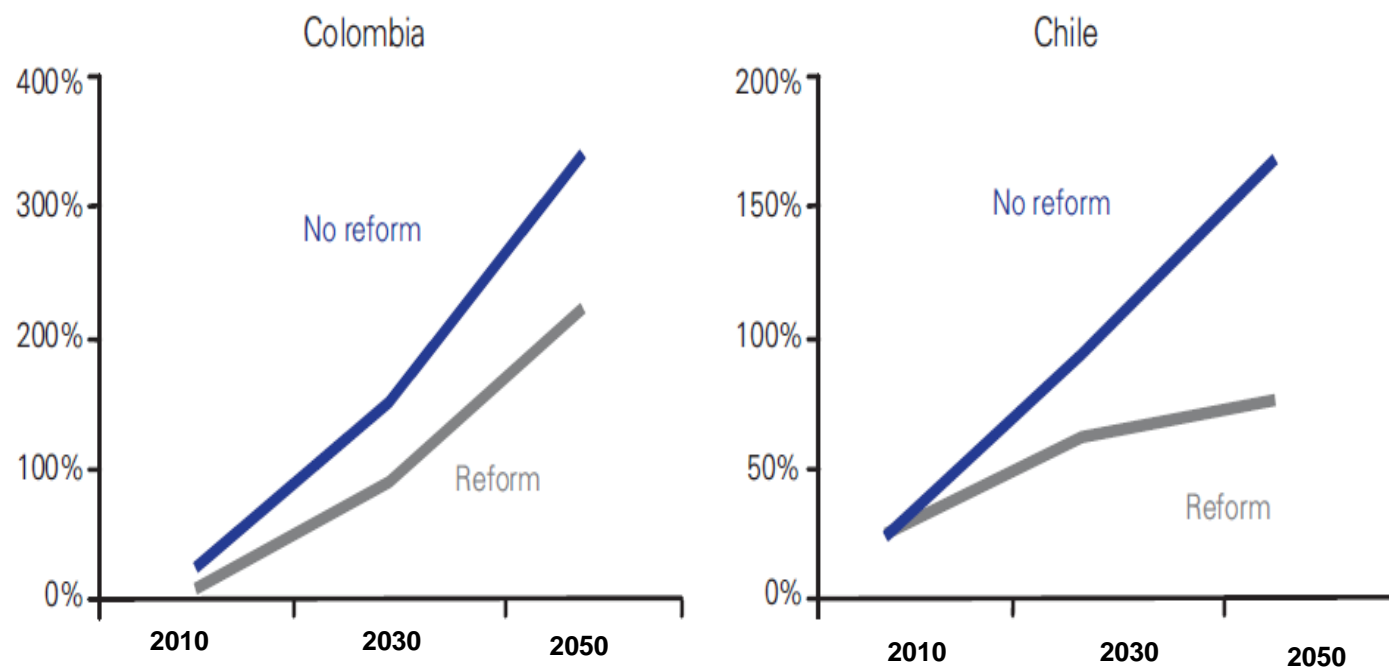
Given all these distortions, changes were necessary

Pension reform key for fiscal sustainability

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Section II: Where
were we?

**CHART 1.9: Estimated pension deficit with and without reform
(as percentage of GDP)**



Pension reforms were necessary to build a sound fiscal stance for Latin America.

A very important reform in Latin America

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Section II: Where
were we?

TABLE 1.1: Pension reform features and models

Country	Date of reform	System	Contribution	Benefit	Financial scheme	Administration
Chile	1981	Private	Defined	Not defined	PIC ^a	Private ^b
Mexico	1997					
Parallel model						
Peru	1992	Public or	Not defined	Defined	Pay-as-you-go	Public
Colombia	1993	Private	Defined	Not defined	PIC	Private ^b

The introduction of a mandatory defined introduction scheme

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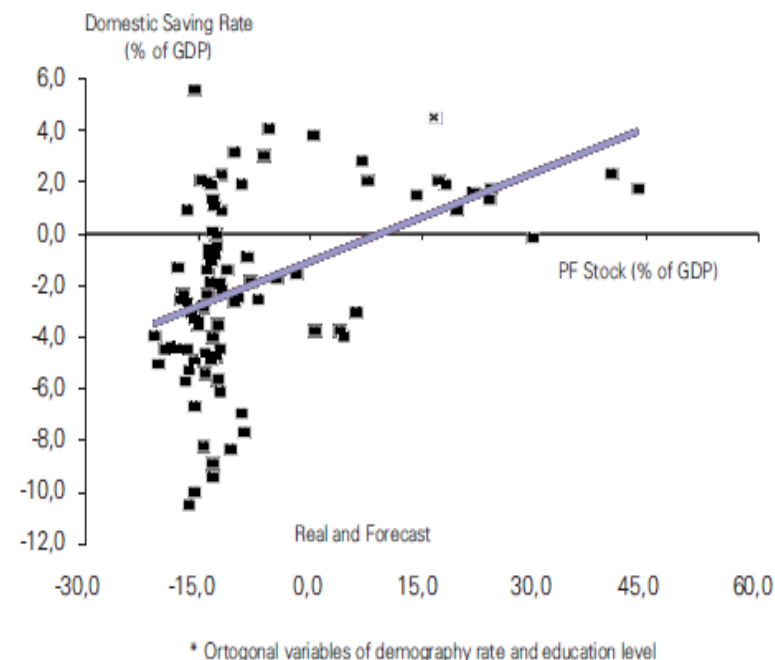
Fundamental changes were implemented

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- Pension Reform in Latam has been fundamental on savings accumulation and sustainable growth.
- Key factor in the consolidation of fiscal, monetary and financial reforms.
- An important foundation for a gradual construction of a well balanced pensions system among benefits, social protection and long term private savings.
- Crucial incorporation of portfolio management experts through the private pension industry.
- Adequate management of risk and return under very well performed regulation and supervision.

CHART 1.8: Impact of GDP on savings



Pension reforms in these countries have been a key variable in the increased structural strength of their economies

Excellent performance

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CHART 1.2: Funds as percentage of GDP (%)

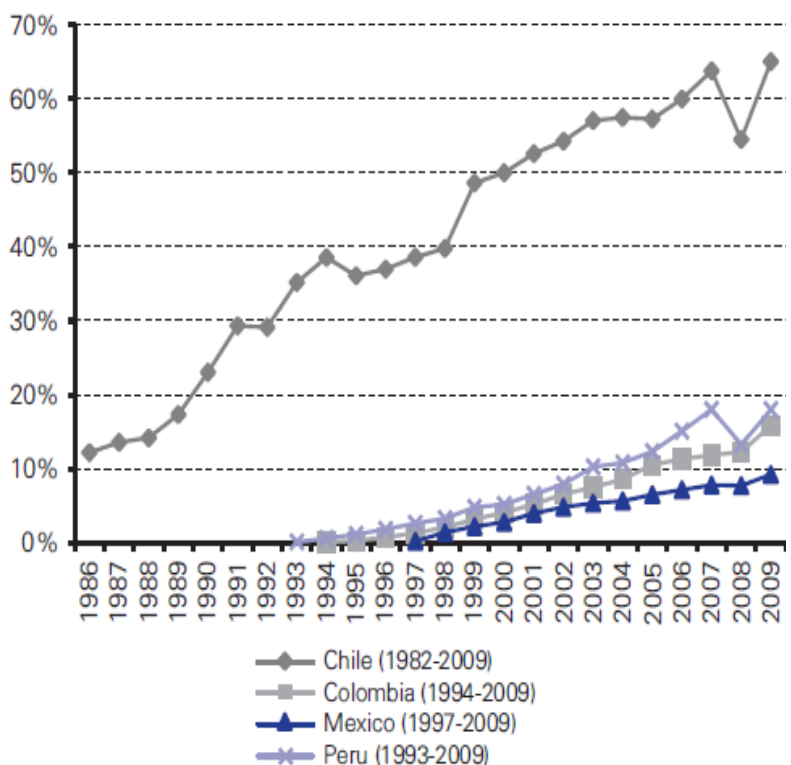


TABLE 1.3: Diversification of holdings by financial instrument (%) (June 30, 2010)

Instruments	Chile	Colombia	Mexico	Peru
Government securities	10,1	42,0	66,0	19,2
Financial	17,3*	5,1	16,0	9,5
Non-financial	11,2*	6,0	11,1
Stocks	14,6	33,5	13,0	30,3
Mutual funds and others	2,4	0,0	3,1
Foreign issues	45,0	11,6	4,0	23,4
Others	-0,6	1,8	1,0	3,4

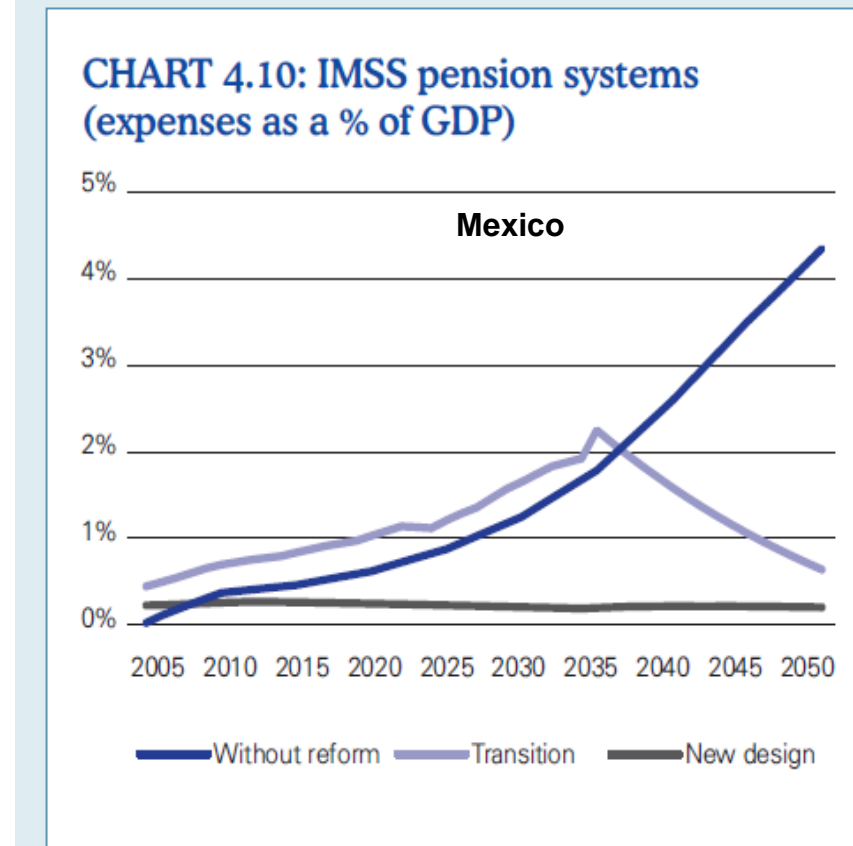
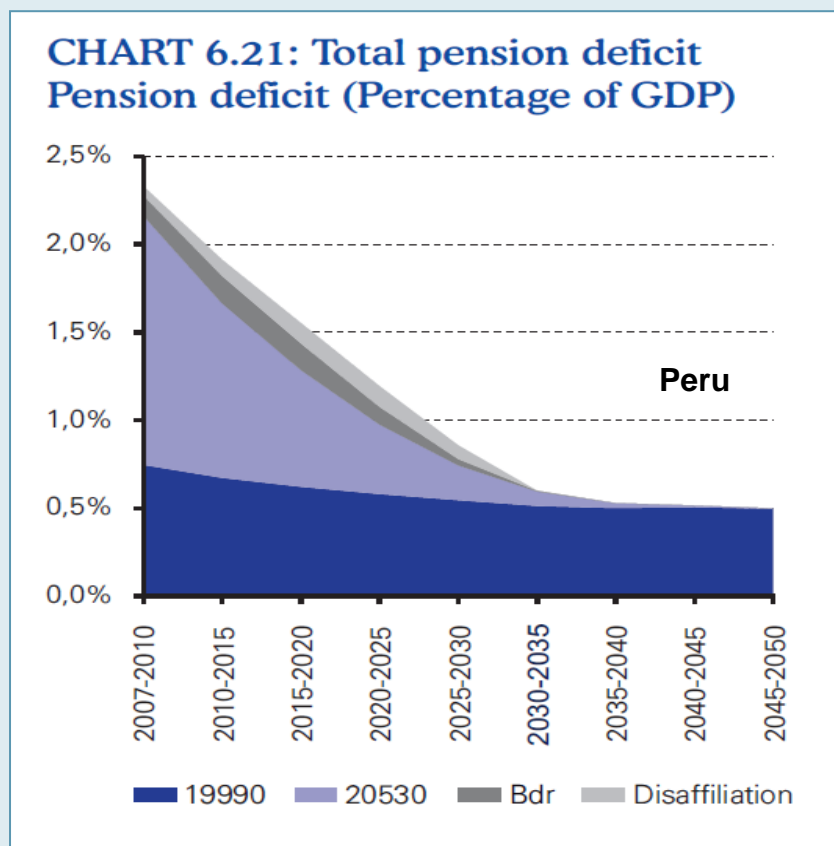
Source: BBVA Research
* Fixed-income

The introduction of specialized managers as well as the introduction of the *multifund* scheme, generated interesting returns and adequate diversification.

Brave decisions on the fiscal side

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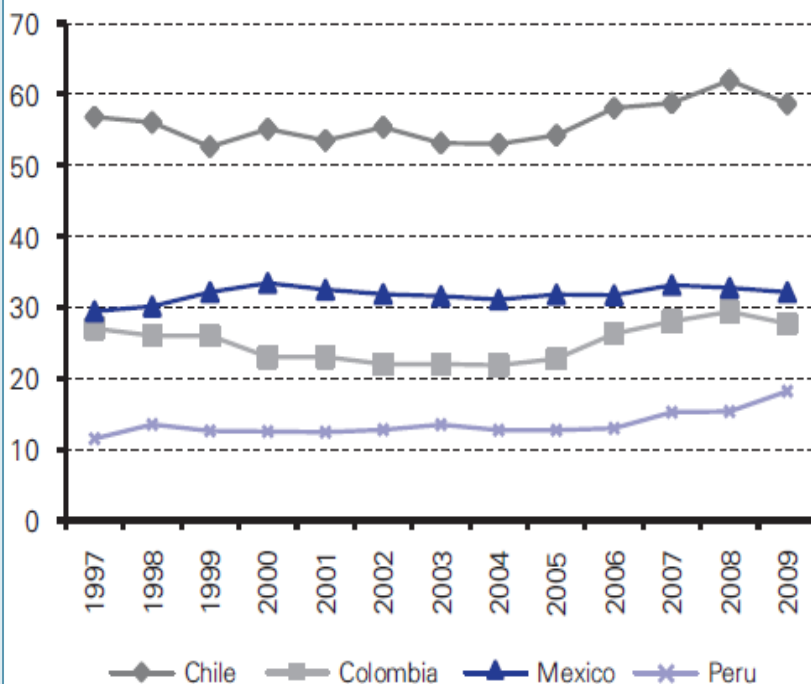
Important reduction in pension expenditures. Political economy in each country conditioned the degree of fiscal consolidation. Actuarial debt as % of GDP: Colombia (150%), Chile (20%), Mexico (91%), Peru (57%).

First steps for increasing pension coverage and providing adequate pensions

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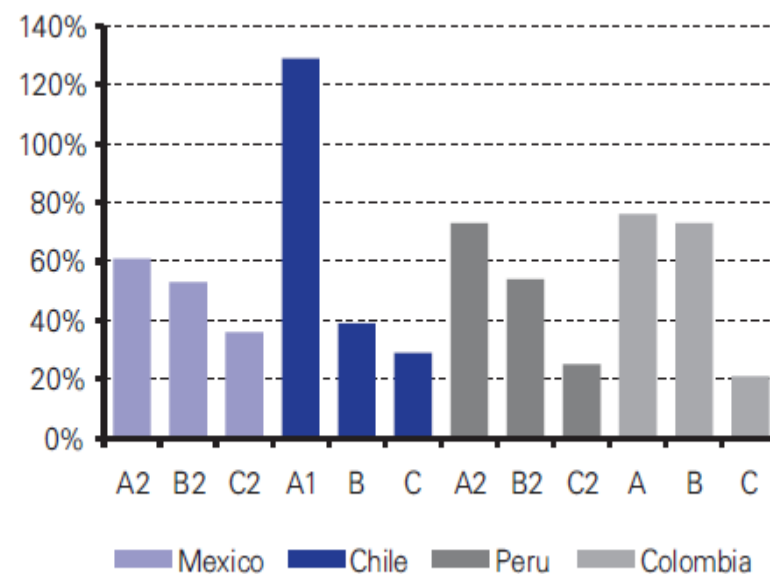
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CHART 1.11: Contributors as percentage of EAP



Source: BBVA Research

CHART 1.10: Replacement rates (%)



Source: BBVA Research

The defined contribution scheme helped those capable to save. High informality, high unemployment, and poverty limited this capacity in important segments of Latam's population.

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The quest for increasing pension coverage

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CHART 5.14: Old-age coverage projection in the medium-term for the RAIS and RPM-ISS

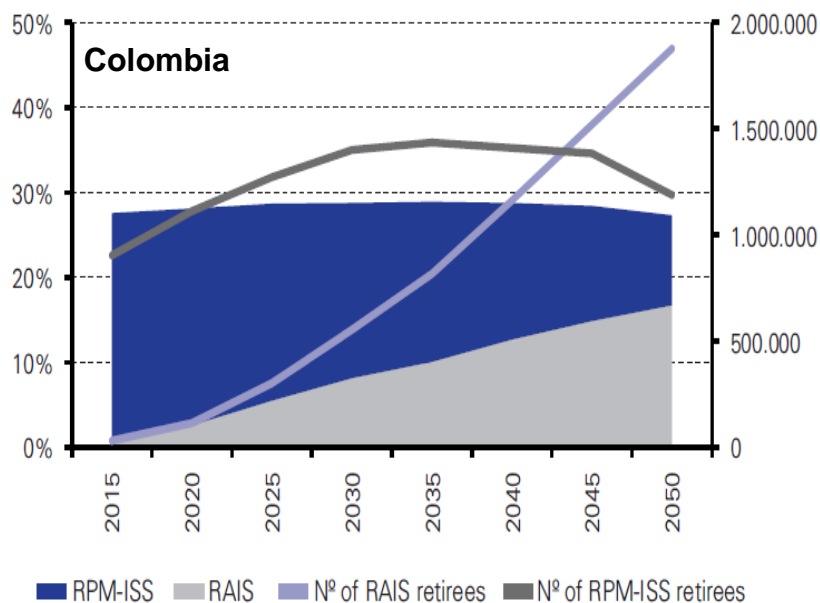
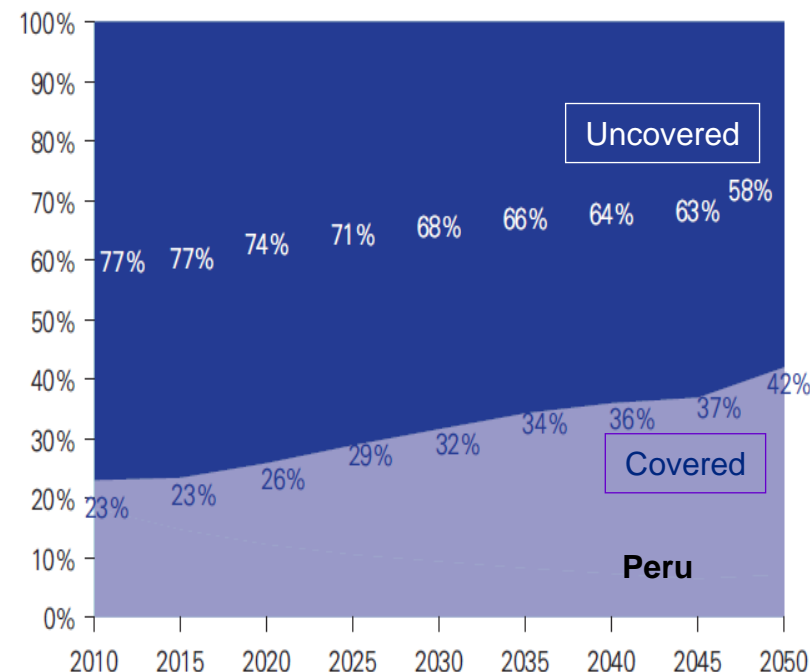


CHART 6.12: Old-age coverage



Except for the case of Chile, the rest of Latam countries will face serious problems to deliver broad pension coverage. The state needs to find paths to incentivize workers to save and to provide focused assistance to those who are really poor.

Adequate replacement rates

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Colombia: RAIS Replacement Rates

Groups	2015	2030	2050
A	75,5%	75,9%	76,3%
B	68,0%	70,7%	72,9%
C	12,6%	17,0%	21,3%
D	2,6%	2,7%	3,7%
Average replacement rate ²	34,0%	41,6%	43,2%

Colombia: RPM-ISS Replacement Rates

Groups	2015	2030	2050
A	92,8%	94,0%	94,1%
B	86,5%	87,3%	88,9%
C	5,4%	7,7%	8,5%
D	1,3%	1,6%	0,9%
Average replacement rate ²	46,5%	47,4%	55,6%

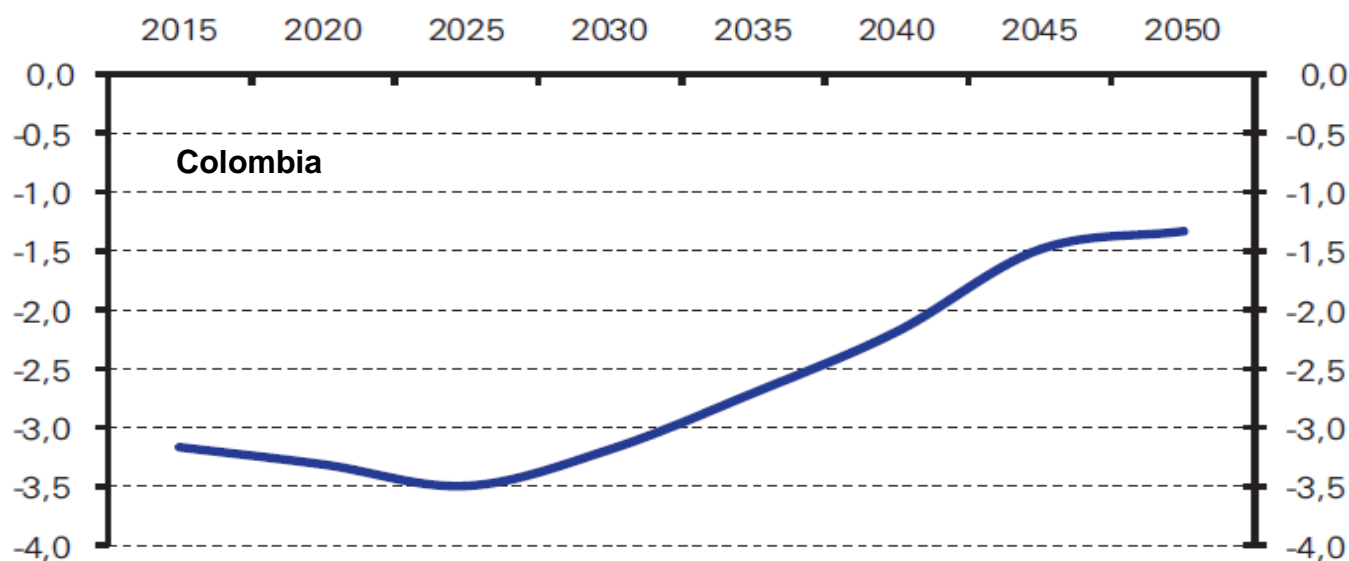
Adequacy of pensions means: (i) a subsistence level for the really poor according to fiscal conditions; (ii) rules related to how much was accumulated (DC or DB); (iii) keep people willing to save; (iv) do not create distortions

To solve pending fiscal problems

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CHART 5.18: Projection of the RPM-ISS pension deficit (percentage of GDP)



Source: BBVA's own calculations

Pension reforms in Colombia during the nineties reduced pension debt from more than 200% to 150%. But the actual burden continues to be high, explained fundamentally by the generous benefits received by some segments (not precisely the poorest).

Non contributory pillar

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CHART 7.8: Reformed old-age pension system in Chile

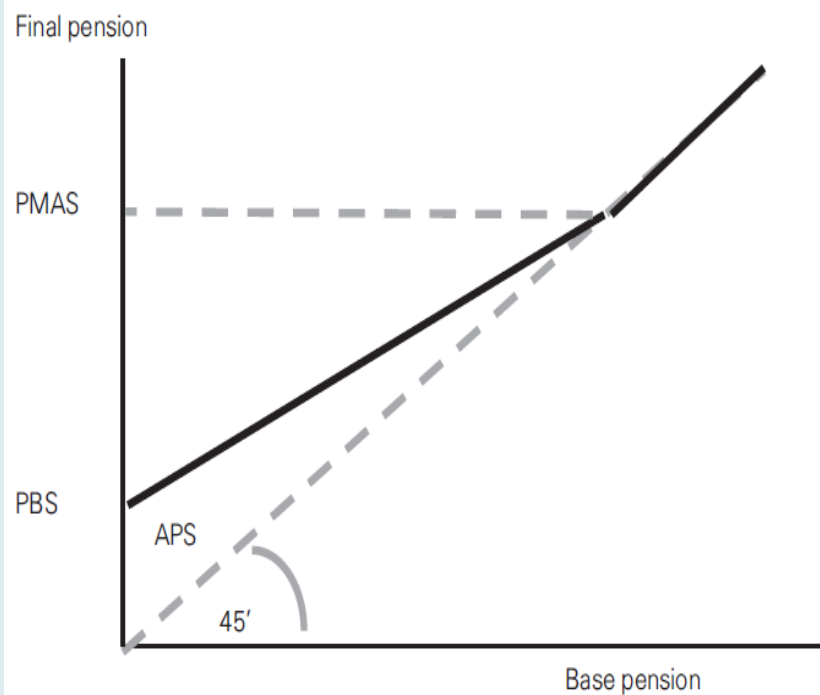
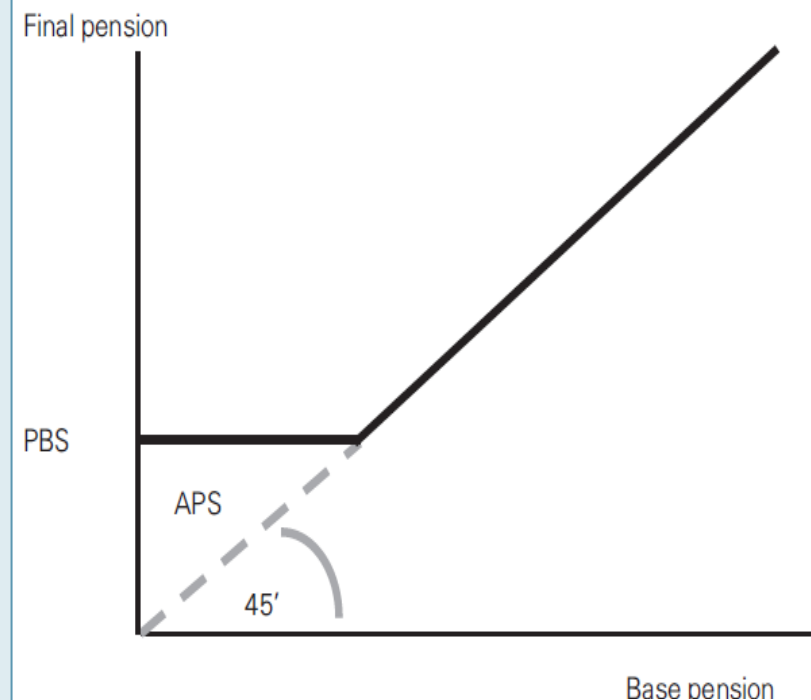


CHART 7.9: Reformed disability pension system in Chile



The challenge is to help the “poorest of the poor”, avoiding to generate disincentives to whom want to save.

Adequate portfolio investment regime

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TABLE 3.4: Real return of pension funds (to April 2010) **Chile**

	Fund Type A Riskiest	Fund Type B Risky	Fund Type C Intermediate	Fund Type D Conservative	Fund Type E Most conservative
Last 12 months (May 2009 - Apr 2010)	35,42%	26,91%	18,08%	11,44%	5,34%
Annual average in last 36 months (May 2007 - Apr 2010)	-3,03%	-0,91%	0,68%	2,11%	3,69%
Annual average since launch of multifunds (Sep 2002 - Apr 2010)	9,14%	7,33%	6,18%	5,28%	3,83%
Annual average since launch of the system (Jun 1981 - Apr 2010)	-	-	9,29%	-	-

Source: Pension Superintendency.

- Excellent result of multifund schemes.
- But there are some aspects that affect the industry: minimum returns+ industry's average return benchmark+reserves for losses.
- Herd effect.
- What is needed?: Adequate assessment of the performance of pension funds, by establishing a known benchmark for portfolio investments based on long term risks and returns.

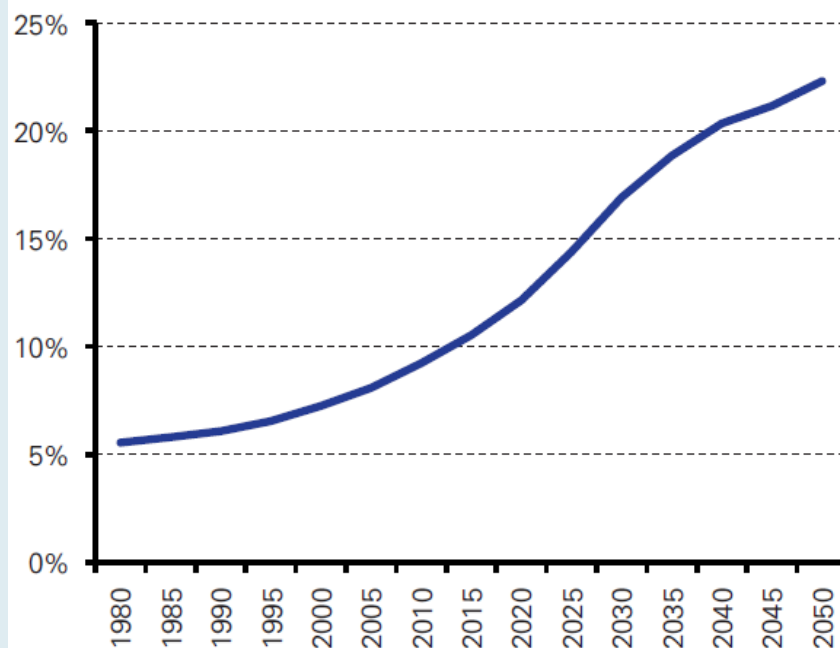
A next generation of reforms is needed.

The Pay out phase

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CHART 3.11: Chile: population aged 65 and over out of the population as a whole



Source: Cepal

- Rapidly aging population in Latam imposes an urgent necessity to assure adequate delivery in the worker's passive stage.
- Longevity risk (how to finance longer life periods?)
- Credit risk (how to avoid life insurance companies from going bankrupt from a bad assessment of new incoming risk?)
- Reinvestment risk (how to assure more long term asset alternatives for adequate investing pension funds in the pay out phase?)

From the cumulative to the pay out phase. Latin America is getting older very fast.

Thank you!

BBVA

Pension reforms in Latin America

Balance and challenges ahead



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