

Pension Reforms in Latin America: Advances and Challenges Ahead

Presentation on the book

March 16th, 2011

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Section 1

Introduction

Contextualizing the reforms

- The dynamics of the reforms
- Reforms and reforms (which can be postponed)
- Unavoidable reforms (nothing can be postponed forever)
- Things to come



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Section 1

Introduction

Aspects that come into play

- Urgencies
- Economic institutions
- Politics
- Structural factors (a limiting factor...)



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Section 2

Starting point for reforms

Politics

Generous, inexpensive benefits

Mismanagement

Unsustainable realities

Unsustainable financial and fiscal risks/parameters of the system not in line with demographic trends

Problems of contribution evasion/mismanagement of funds/costs of management/opacity to the distribution of funds



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Section 3

What has been achieved?

A key structural reform for Latin America

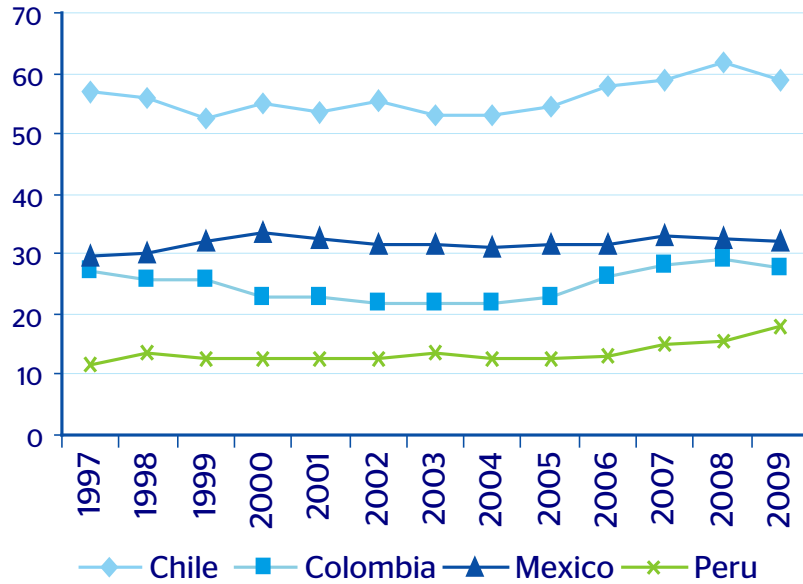
A cornerstone to building a pension system that puts into balance efficiency and equity

Section 3

What has been achieved?

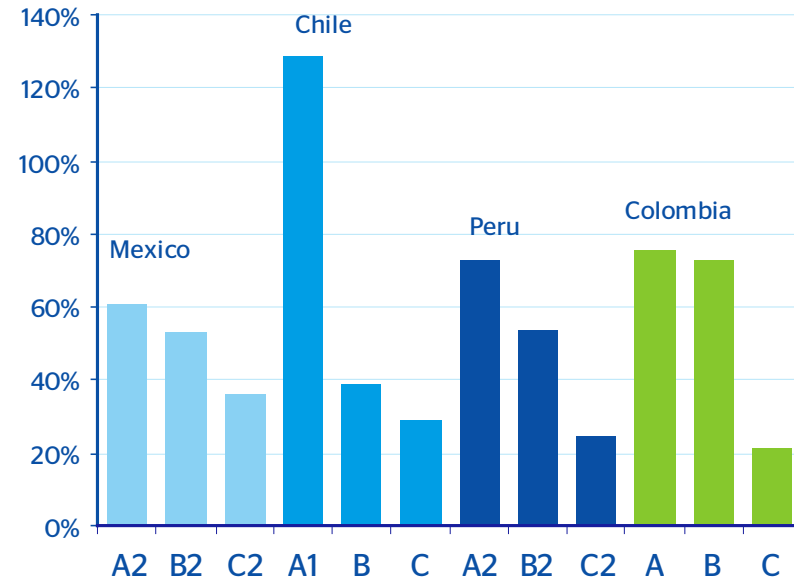
Contributors as a percent of beneficiaries (EAP)

Source: BBVA Research



Replacement rate

Source: BBVA Research





Section 3

What has been achieved?

A key structural reform for Latin America

- A cornerstone to building a **pension** system that puts into balance **efficiency and equity**
- Key role for **fiscal consolidation**
- Important part of the **monetary policy** channel



Section 3

What has been achieved?

A key structural reform for Latin America

- A cornerstone to building a pension system that puts into balance efficiency and equity
- Key role for fiscal consolidation
- Important part of the monetary policy channel
- Innovative actor in capital markets
- Impact on growth
- Regulatory framework

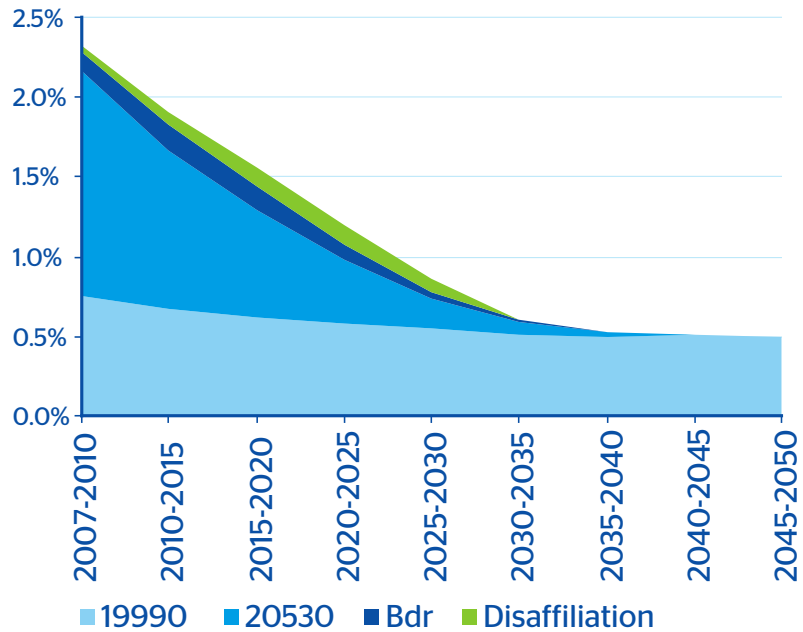


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What has been achieved?

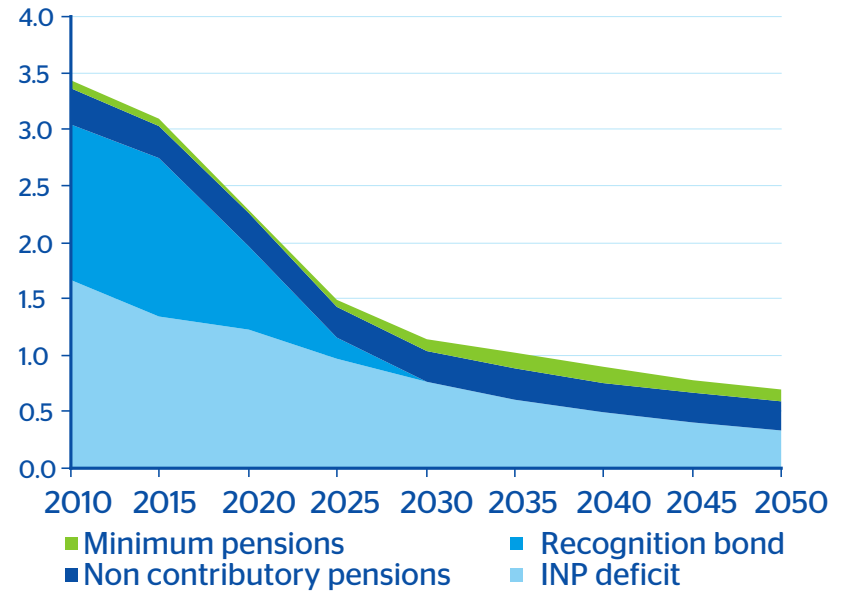
Peru: Pension deficit as a percent of GDP

Source: ONP, MEF, SBS, BBVA



Chile: Pension deficit as a percent of GDP

Source: Favre et al. (2006)

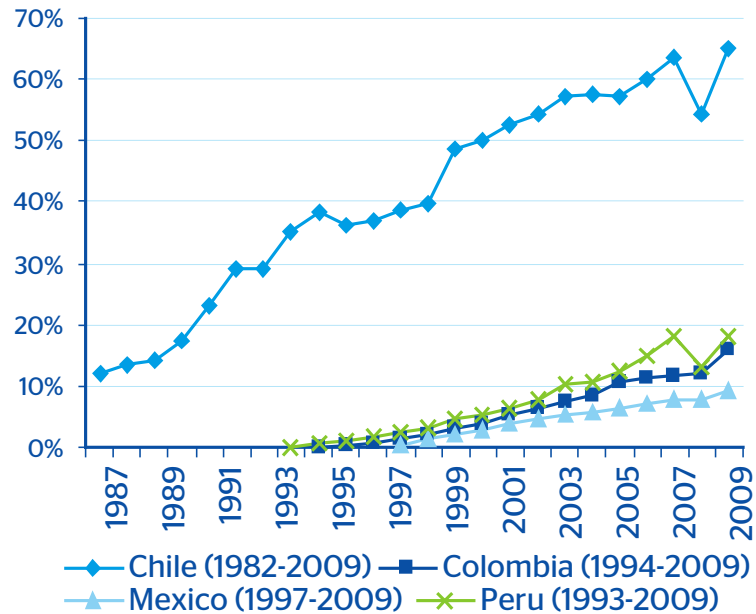


Section 3

What has been achieved?

Pension funds as a % of GDP

Source: BBVA Research



Investment portfolios

* May 2010, **fixed-income
Source: BBVA Research

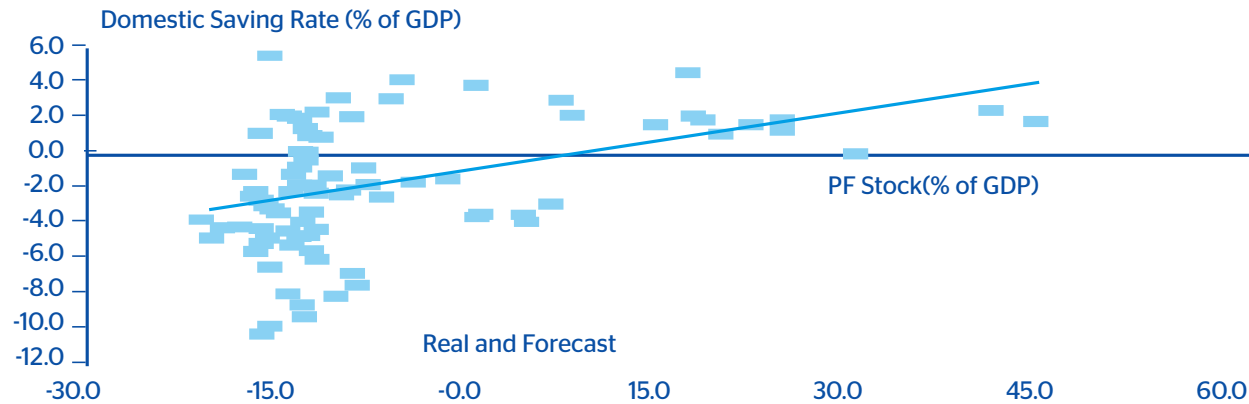
Instruments	Chile	Colombia*	Mexico	Peru
Government securities	10.1	42.0	66.0	19.2
Financial	17.3**	4.2	16.0	9.5
Non-financial	11.2**	5.4	11.1
Stocks	14.6	0.0	13.0	30.3
Mutual funds and others	2.4	36.1	3.1
Foreign issues	45.0	12.3	4.0	23.4
Others	-0.6	1.0	3.4

Section 3

What has been achieved?

Growth and pension funds

Source: Corbon, Scmidt, Hebbel - 2003



Pension funds and infrastructure projects

(1) Electricity, Water, Telecommunications; (2) Excludes SB1 and SB2 with 0 and 5% respectively; (3) December 2008

Source: BBVA Research

	(USD\$ millions)	Indirect Investment (% portfolio)	(USD\$ millions)	Direct Investment (% portfolio)	Maximum limits of direct investment in infrastructure (% portfolio)
Chile	9969(1)	9.17%	1956	1.80%	Without specific limit
Colombia	4431 (3)	17.10%	0	0	Without specific limit
Mexico	5535	6.90%	0	0	10% (2)
Peru	2416	11.50%	700.2	3.30%	Without specific limit



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Section 4

What lies ahead

More challenges ...

Extend participation



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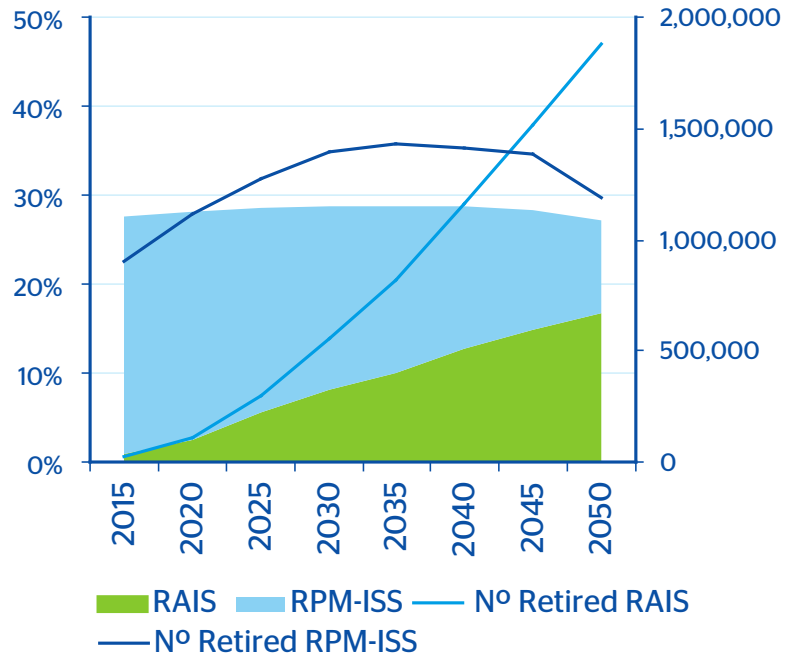


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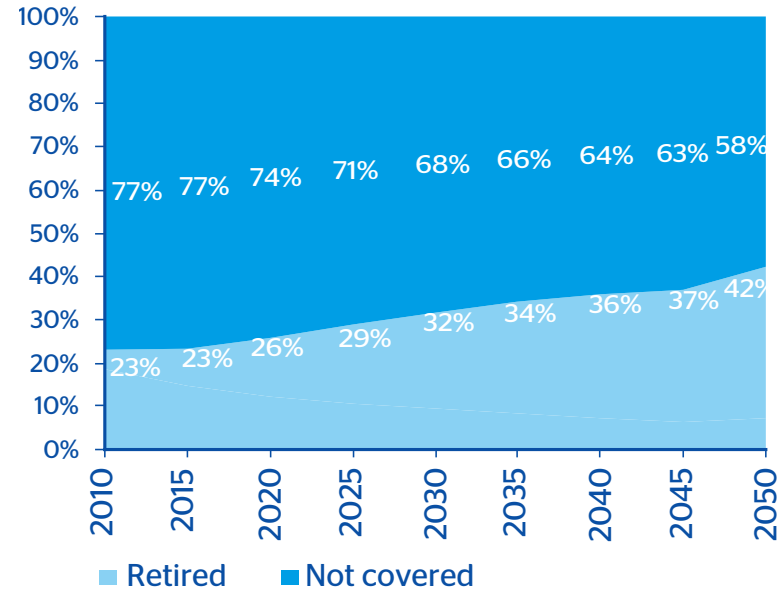
Colombia: Coverage of the elderly

Source: BBVA Calculations



Peru: Coverage of the elderly

Source: SBS, ONP, BBVA/Elaboration





Section 4

What lies ahead

More challenges ...

- Extend participation

Various alternatives ...

- Matching contributions
- Benefit pools
- Universal schemes
- Focused help

.... the challenge is to not disincentive voluntary saving



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Section 4

What lies ahead

More challenges ...

- Extend participation
- Reduce distortions in distribution systems
- The challenge of fiscal sustainability

Section 4

What lies ahead

Colombia: Replacement rates of the private system (RAIS)

Source: BBVA calculations

Group	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%
Replacement Rate Average	34,0%	41,6%	43,2%

Colombia: Replacement rates of the PAYGO system (RPM)

Source: BBVA calculations

Group	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%
Replacement Rate Average	46,5%	47,4%	55,6%



Section 4

What lies ahead

More challenges ...

- Extend participation
- Reduce distortions of distribution systems
- The challenge of fiscal sustainability
- Changing demographics



Section 4

What lies ahead

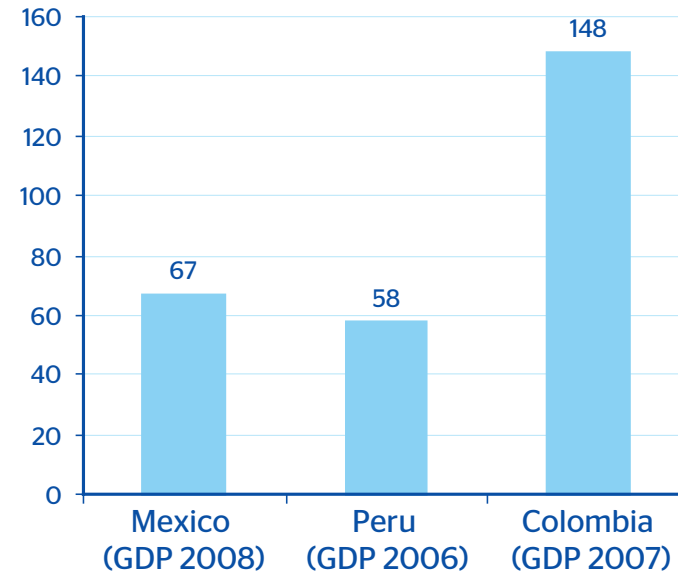
Colombia: Comparison of average replacement rates

Source: BBVA calculations

2015	2030	2050
Average Replacement rate		
70,0%	73,5%	74,6%
2015	2030	2050
Average Replacement Rate		
89,7%	90,1%	90,9%

Projections of the net present value of pension debt

Source: Albo et al (2007), National Provisional Office of Peru, Social Protection Ministry of Colombia/ BBVA calculations



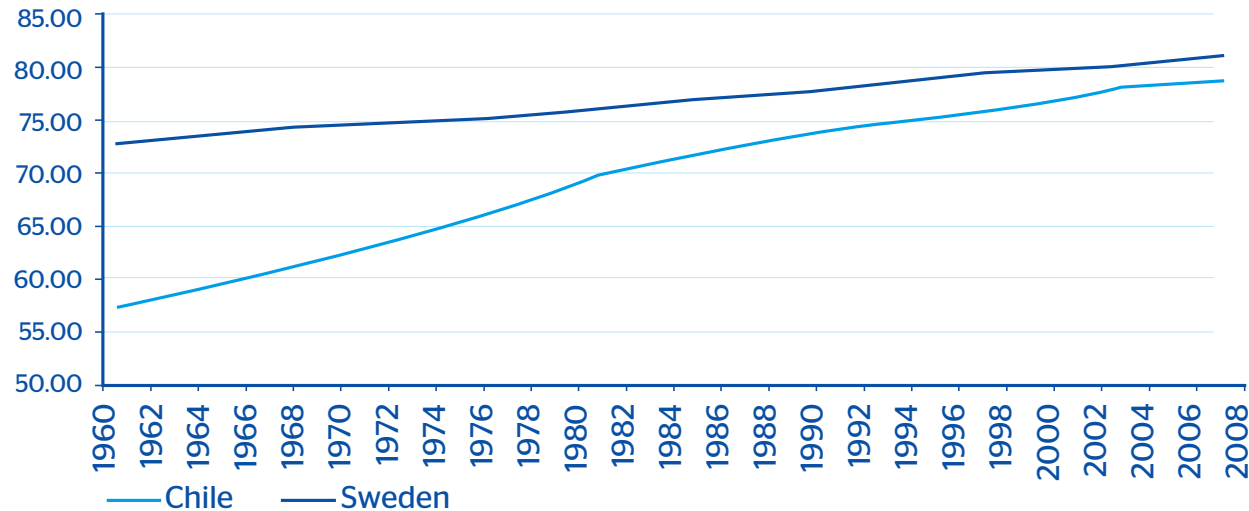
Note: Peru's estimation takes into account the actuarial present value between 2006 and 2050. The discount rate used is 4% for Mexico and Colombia.

Section 4

What lies ahead

Life expectancy from birth: Chile and Sweden

Source: UN population statistics



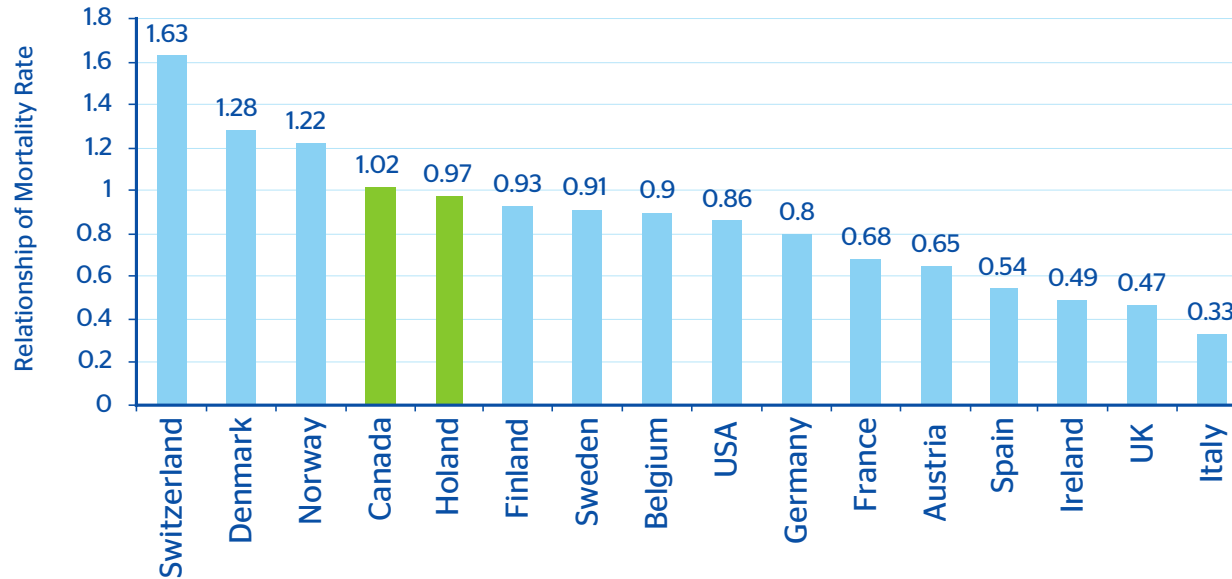
- Longevity risk: How to finance a longer lifespan
- Credit risk: How to prevent insurers from falling into financial problems due to poor assessment of this new risk?
- Reinvestment risk: How to secure more long term assets that are appropriate for the investment of pension funds during the retirement phase?

Section 4

What lies ahead

Ratio of the probability of death considered by the industry to that which is observed

Source: Groupe Consultative Actuariel Européen - The Cass Business School (2005)



- The differences are apparent between the survival probability used by the industry and that which is observed
- An annuity can vary as much as 20 percentage points when the other alternative mortality table is used in the country

Thank you

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