Tripartite round table on pension trends and reforms

Overall assessment of the pension system

Chile (Employers)

1. Fulfilment of the core principles of the ILO:

(a) Based on your evaluation of your country's pension system, which core principles embodied in ILO standards does the pension system fully or partially observe? Please explain your answer.

The ILO core principles with which the Chilean pension system is, in our opinion, largely in compliance are the following:

- Progressive realization of universal coverage:

➢ *Improved active-stage coverage*, since individual capitalization systems provide greater incentives for paying contributions because these contributions amount to personal savings over which affiliate members have the right of ownership. Active-stage coverage in Chile is among the highest in the Latin American region (61 per cent of the economically active population in 2019, compared to 46 per cent in 2000).

➢ *Improved passive-stage coverage*, since (a) all workers with individual retirement account savings have the right to a pension or to withdraw the entirety of their accumulated balance, including the returns obtained, irrespective of the number of years of contributions (whereas, in redistributive, or pay-as-you-go, systems a worker who had not met the qualifying years of contributions would lose all or part of their savings, resulting in a pension equal to zero. Approximately 50 per cent of workers in the old pay-as-you-go system did not meet the qualifying number of years of contributions and so did not obtain a pension); and (b) by releasing fiscal resources previously spent on financing generally regressive pay-as-you-go schemes, individual retirement accounts systems allow for the financing of solidarity – or non-contributory – pensions, which go towards supporting the most vulnerable workers (fiscal space enabled Chile to create solidarity pensions as part of the 2008 pension reforms; the solidarity pillar currently benefits more than 1.6 million of the poorest 60 per cent of the population; the basic pension is US$218 for persons over the age of 80, that is 99 per cent of the poverty line).

- Social solidarity and collective financing:

➢ Social solidarity comes from: (a) the capacity of the individual accounts system to generate long-term fiscal space and thus allow for the creation of a non-contributory pension system, financed through general taxes, to help support the most vulnerable persons; and (b) the elimination of the regressive cross-subsidies that existed between lower- and higher-income workers in redistributive systems (when workers who did not meet the qualifying years of contributions (usually lower-income and informal workers) lost their savings, they ended up subsidizing workers with higher incomes or more stable careers).

➢ Other solidarity mechanisms: disability and survivor's insurance, unemployment insurance, allowances in the case of divorce or annulment; child bonuses; and subsidies for hiring vulnerable young workers.

- **Overall and primary responsibility of the State:** The State's responsibility with regard to the pension system lies in its subsidiary, regulatory and supervisory roles, through which it ensures adequate competition between administrators and the fulfilment of obligations. The State also regulates: the overall direction of pension fund administrators (PFAs) to prevent conflicts of interest; the separation between PFAs and pension funds; and the fiduciary obligations of PFAs to invest with solely profitability and security considerations in mind.

- Non-discrimination, gender equality and responsiveness to special needs:

➢ Disability and survivor's insurance funded by employers protects workers and their families in the event of disability due to accident or illness and death.

➢ Additional contributions for workers who perform arduous jobs, which exert a greater toll on workers, financed by both employers and workers.

➢ Equal treatment: the savings that workers have accumulated belong to them, meaning that, even if they have only paid contributions for a small number of years, they will always have the right to a pension. This is not the case in Latin American pay-as-you-go systems, where a minimum number of years of contributions is required in order to obtain a pension; if those requirements are not met, workers are not entitled to a pension and lose their contributions. Migrant workers are treated in the same way as local workers and can access benefits if they meet the same requirements as local workers. Pension fund portability agreements are in place with several countries (such as between Chile and Peru).

- **Financial, fiscal and economic sustainability:** the system is fiscally and economically sustainable in the medium and long term because the current system has entirely replaced the old pay-as-you-go system. If the reform that created the individual capitalization system had not been implemented in 1980, even with parametric reforms the pay-as-you-go system's deficits would have reached almost 8 per cent of GDP by the 2050s, which would have been highly unsustainable. The fiscal spaces created by the PFA system enabled the creation of a solidarity pension system, which targets spending for the poorest and represents around 0.6 per cent of GDP.

- **Transparent management and administration:**

➢ Pension fund administrators and oversight bodies regularly provide affiliate members and the general public with updated information, through various means, on their savings, the returns obtained, the yields on pension fund investments, the administration fees paid by members and the quality of service provided by administrators.

➢ There is separation between the regulatory, monitoring and supervisory role, which is the responsibility of the State, and the administrative role for pension fund accounts and investments, which is primarily the responsibility of private managers in a competitive environment. Pension fund investments must only be for the purposes of the profitability and security of those funds, and PFAs can only invest in those instruments and within those limits authorized by the law and only through established secondary markets.

(b) In your view, which core principles embodied in ILO standards are not observed or are only partially observed by the pension system? Please explain your answer.
The following principles are only partially observed:

- **Right to adequate and predictable benefits**

➢ Contributions to the individual capitalization pension system are invested in the capital markets in highly diversified national and international assets. As such, the accumulated balance will depend on the profitability of those assets, which may vary. In the case of Chile, 70 per cent of the accumulated funds stems from returns on those funds and just 30 per cent comes from contributions.

➢ That being said, the main reasons why the pensions provided by the PFA system do not meet the expectations of many members include: (a) the increase in life expectancy upon retirement, which has not been accompanied by increases in the legal age of retirement or contribution rates; and (b) the long periods of working life when persons do not pay into the system because they are inactive, unemployed or working in the informal sector. Regarding informality, for example, 84 per cent of persons currently receiving an old-age pension from the Chilean pension system had paid contributions for less than 30 years, which is the threshold defined by the ILO for a replacement rate of 40–50 per cent. Contribution rates in Chile are 10 per cent, around half the average for Organisation for Economic Co-operation and Development (OECD) countries. Lastly, between 1981 and the present-day in Chile, increased life expectancy on retirement and an unchanged legal age of retirement mean that the average number of years living on a pension rose by 8 years, from 22 to 30 years, for women, and by 7 years, from 14 to 21 years, for men. In other words, the low density of contributions must finance a pension period of 30 years for women and 21 years for men. **The effect of demographic change is undeniable: pensions would be worth double those of today if the life expectancies and interest rates used for calculating pensions had remained the same.**

➢ There are also other relevant factors influencing low pensions, such as contribution evasion and avoidance, young people's later entry to the labour market, and low wages. These problems have a negative effect on both individual capitalization systems and pay-as-you-go schemes.

➢ By contrast, pensions and effective replacement rates provided by Latin American individual capitalization systems to members who have retired and **paid contributions with a degree of regularity** have been high and even above those suggested by international organizations, despite the currently low contribution rates. In Chile, for example, as of December 2019 those persons with the highest number of years of contributions (more than 35 and less than 40 years), men received a pension of 74.4 per cent and women 70.4 per cent of the average taxable income earned in the ten years prior to reaching pensionable age.

➢ The most vulnerable sector of the Chilean population receives state funding for their pension, even when they have not made any contributions or have very little funds in PFAs, through the Solidarity Pillar (following the 2008 reform), the basic objective of which is to prevent poverty in old age. This solidarity pension was established as a result of the long-term fiscal space created by the PFA system.

➢ Proposed pension reforms that would increase contributions by 6 percentage points (financed by employers) are currently being discussed by Congress. Increasing contributions to individual accounts would generate a higher accumulation of funds and thus contribute to improving the adequacy of pensions provided by the PFA system. Due to the current coronavirus disease (COVID-19) pandemic, however, the early withdrawal of the equivalent of 10 per cent of pensions was approved, which **negatively affects the adequacy and predictability of the pensions that the system can provide**. A legislative process is also under way to allow for a second withdrawal of 10 per cent in December. It is estimated that the first withdrawal will leave 1.9 million persons with a zero balance for their retirement. The negative effects will only be exacerbated by a possible second withdrawal of 10 per cent: 4.2 million persons would be left without a balance for retirement and, on average, affiliate members would be left with 51 per cent of their initial savings; in turn, pensions would fall by 23 per cent.

- **Involvement of social partners and consultations with other stakeholders:** Affiliation to a PFA is individual and not on the basis of a worker's company or type of activity or economic sector. For this reason, it would be unreasonable for unions or employers to be involved in the administration of the PFA, because company or union workers are in different PFAs. That is why the law provides for a user's committee, that is, a social engagement entity composed of different social actors whose function is to assess the functioning of the pension system and propose pension-related educational and outreach strategies. Moreover, some PFAs have voluntarily established their own users' committees, with members elected from among their own affiliates, and have introduced annual public audits in which their members are invited to participate.

- **Periodic review of pensions to match the evolution of the cost of living and level of earnings:** Currently, no institutional framework exists that would enable periodic and technical adjustments to be made to the main parameters of contributory programmes in order to ensure that they are consistent with pension targets. An institutional framework is required that has the authority to periodically review the main parameters of the system (pension age, contribution rate, taxable limits) and to propose changes based on technical arguments that take into account changing demographic trends and labour and financial market dynamics.

2. What is your overall assessment of your country's pension system?

In the Mercer 2020 Global Pension Index, Chile is second only to Canada in the region of the Americas and is in 13th place globally, with 67 points out of a possible 100. Chile has good sustainability and integrity indicators but the adequacy indicator is slightly below the average for the countries analysed, demonstrating that there is an opportunity for improvement for this latter indicator, which refers, among other things, to the level of benefit levels relative to income levels.

3. In what ways could the pension system be strengthened?

➢ It is necessary to identify the true causes of the low replacement rates, while avoiding demagogic or populist measures that end up weakening pension systems and fail to resolve the issues surrounding pensions. The solution to the pension problem does not lie in a return to pay-as-you-go systems, since these are unworkable given that, with population ageing, there will be steadily fewer active workers for every older person, a situation only exacerbated by informal working.

➢ The measures required to strengthen the PFA system include:

- Provide individual capitalization systems with technical institutions to periodically update their parameters (contribution rates and retirement age). An alternative option is to establish automatic adjustment mechanisms by law, such as indexing the retirement age to life expectancy, or automatic adjustments to maximum contributory earnings.

- Improve returns on pension fund investments: make pension fund investment limits more flexible and include alternative assets in the portfolio of eligible instruments.

- Strengthen voluntary pension savings through tax incentives and mechanisms based on behavioural economics, such as automatic enrolment and automatic increases in contributions over time.

- Improve advisory services for affiliate members during both the accumulation and decumulation stages.

- Find new mechanisms for collecting contributions that help achieve universal coverage, such as by collecting contributions through consumption.