Gobierno de Chile

Superintendencia de Pensiones

THE INTERACTION BETWEEN PUBLIC AND PRIVATE RETIREMENT PROVISION

ICI Global – IOPS – OECD Conference
June 24, 2015
Paris, France

Olga Fuentes
Deputy Chairman of Regulation
Superintendence of Pensions, Chile

MOTIVATION

- Which elements need to be taken into consideration to have a good interaction between private and public provision?
  - Risk sharing
    - In a DC scheme the individuals bear all risks (investment, human capital, annuitization, longevity).
  - Impact on incentives
    - Public provision can have effects on different types of decisions:
      - Contribute or not contribute
      - On the amount of the contribution
      - On the timing of the contributions
  - Goal: Smooth consumption and alleviate poverty
    - Increase coverage of the pension system and a safety net for individuals who are not able to contribute or contribute infrequently.

MOTIVATION

Key Trade-Off

Protection and the need of risk-sharing versus the impact on incentives

Public provision before the 2008 reform: Minimum Pension Guarantee (MPG)

- Before the pension reform of 2008, there were 2 guarantee mechanisms in terms of absolute pension levels:

    - Minimum Pension Guarantee, MPG
    - Welfare Pensions, WP

- Both aimed at providing a consumption floor for those who did not save for retirement or did so insufficiently.

Public provision before the 2008 reform: Minimum Pension Guarantee (MPG)

- MPG requirements:
  - Age:
    - Women 60+
    - Men 65+
  - Minimum number of contributions: 240 and have depleted pension savings
  - Self financed pension<minimum pension

PUBLIC PROVISION BEFORE THE 2008 REFORM: MINIMUM PENSION GUARANTEE (MPG)

❖ What risks are covered?

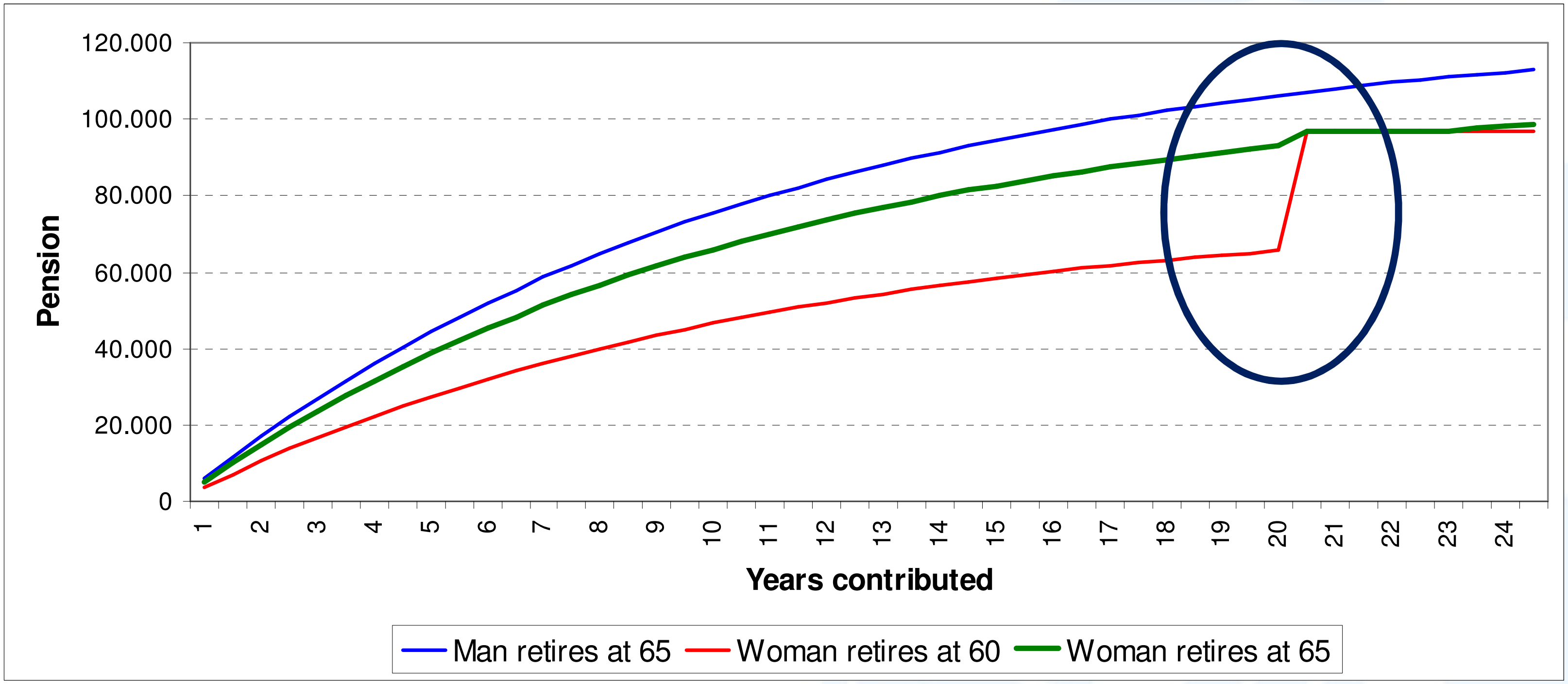
- Human capital risk partially covered for those with more than 240 months of contribution that qualify to get the MPG.
- It partially covers investment risk, since the MPG is not related to the value of self-financed pension once the threshold is satisfy.
- It covers longevity risk, inflation risks for the ones that qualify for MPG.

Public provision before the 2008 reform: Minimum Pension Guarantee (MPG)

- What are the effects on incentives?
  - It depends on gender, time path of contributions, level of labor income and age at retirement.
  - Strong incentives to contribute to satisfy the requirements of 240 contributions.
    - Most probably for women, with low labor income, who retires at age 60.
    - Indifferent: Single men, who retires at age 65.
    - Some incentives: married men, and women who retires at age 65.
  - Incentive to not make more contributions than 240 months.
  - Implicit tax rate on pensions savings=100% after 240 months.

PUBLIC PROVISION BEFORE THE 2008 REFORM: MINIMUM PENSION GUARANTEE (MPG)

- Incentives and Access to the MPG



The MPG was **weakly** integrated to the 2nd pillar

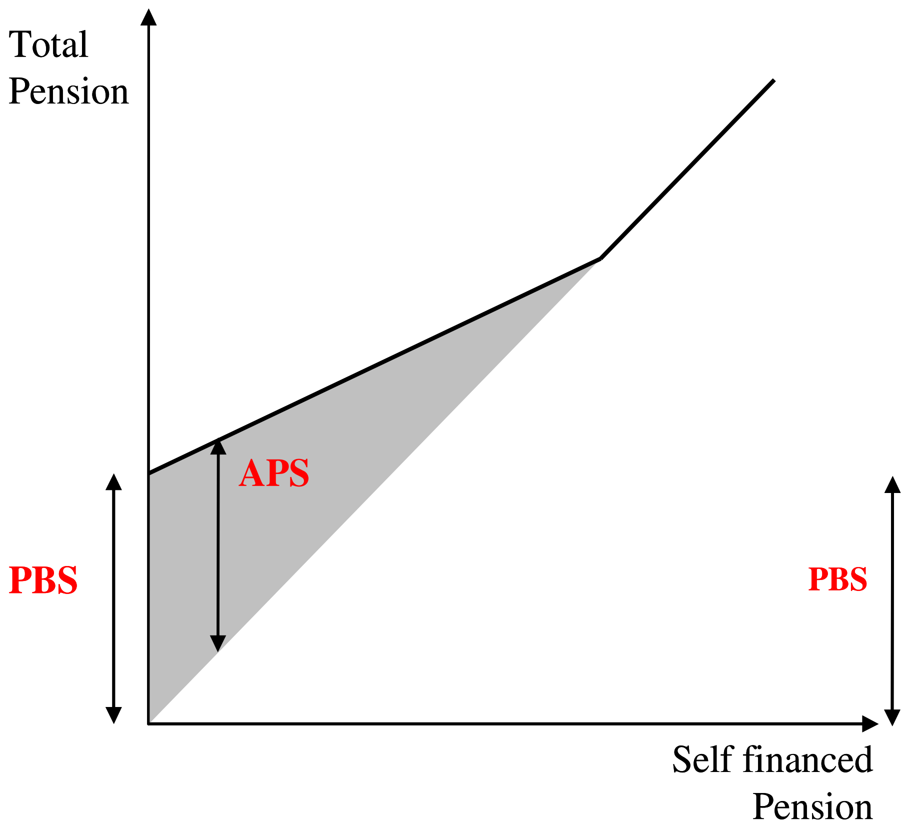
Individuals with unstable pension system participation did not access the MPG and the ones that meet the requirement were likely to self-fund a pension higher than the Minimum Pension

A BETTER INSTRUMENT: THE SOLIDARITY PILLAR INTRODUCED IN 2008

- With the Reform of 2008:
  - A wider First Solidarity Pillar was introduced
    - Basic Solidarity Pension for individuals who could not contribute: Old age and disability
    - Solidarity Complement for individuals who financed small pensions: Old age and disability
  - Fully integrated First Pillar to the Second and Third Pillars
  - Provide protection and at the same time aim to keep the incentives to save.
  - It works as a subsidy to increase total pensions

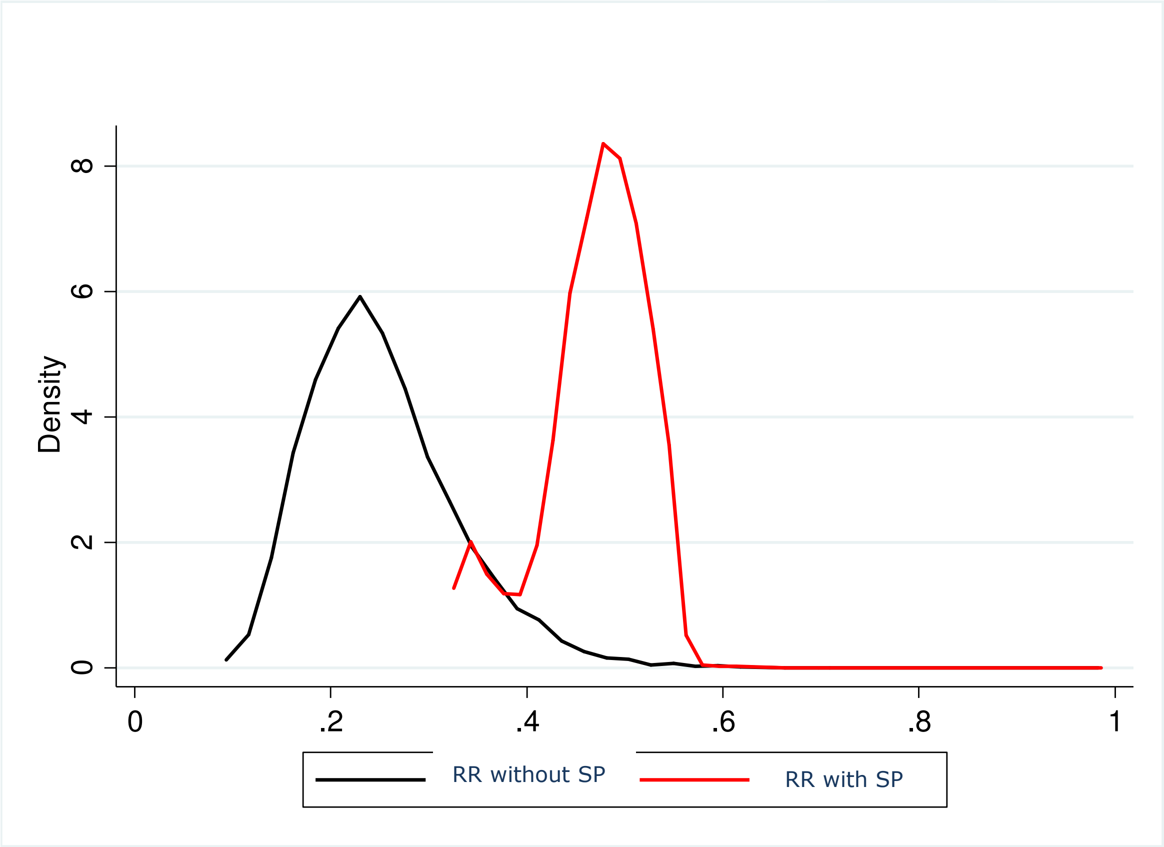
SOLIDARITY PILLAR: A SUBSIDY TO INCREASE PENSIONS

Old age Solidarity Benefits



Solidarity Pillar: a subsidy to increase pensions

Impact on pension risk of the Solidarity Pillar



Solidarity Pillar: a subsidy to increase pensions

- What risks are covered?

- The Solidarity Pillar insures against longevity and inflation risk.

- The Solidarity Complement insures against human capital and investment risk, since it is a complement to the pension, determined by the value of the self-financed pension.

- Since there is <u>no requirement</u> in terms of a minimum number of contributions, there is <u>no incompatibility</u> with having low density contributions, which is exactly the group of individuals we want to cover (those with high human capital risk, unstable jobs and very low contributions densities)

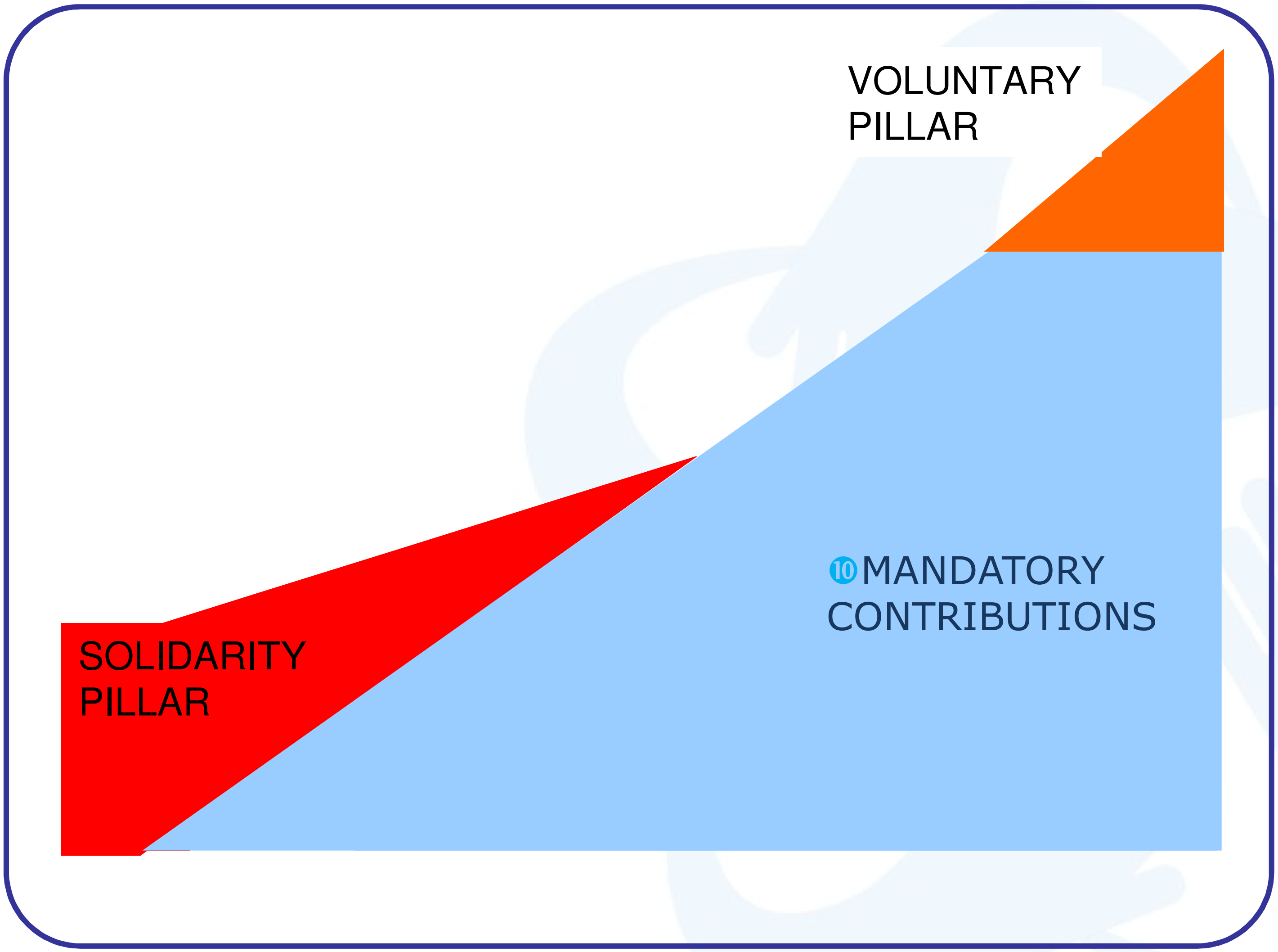
Solidarity Pillar: a subsidy to increase pensions

- What are the effects on incentives?
  - Keeps to some extent the incentive to save
  - The solidarity complement means that the pension is strictly increasing in pension savings.
    - The Solidarity complement has an income effect (higher pension benefits) and a substitution effect (implicit tax rate on pension savings) that would decrease pension savings.
    - However, the implicit tax rate on pension savings is 30% as opposed to 100% for the MPG.

THE 2008 REFORM: MAIN RESULTS

- Solidarity Pillar
  - Mean Tested: belong to the least affluent 60% of the population
  - Basic Solidarity Pension (PBS) for individuals who could not contribute
    - PBS = $85.964 monthly (US$ 137)
    - PBS pensioners= 583.202 (68% women)
  - Solidarity Complement (APS) for individuals who financed small pensions below a threshold
    - Threshold: PMAS = $279.427 (US$ 443)
    - APS pensioners= 698.426 (58% women)
    - APS Old age pensioners represent 45% of all pensioners
    - The APS complement represents 80% of the total pension for those whit APS

A More Integrated Pension System



Final Remarks

- A good interaction between public and private provision requires:

- Careful design of instruments: which are the risks that want to be covered and the impact on incentives

- The solidarity pillar in the case of Chile is better instrument in terms of protection and incentives than the previous MPG

- By design: The solidarity complement implies that the pension is strictly increasing in pension savings.

- Main Challenge: Continue improving adequacy with a financially sustainable system.

THE INTERACTION BETWEEN PUBLIC AND PRIVATE RETIREMENT PROVISION

ICI Global – IOPS – OECD Seminar
June 24, 2015
Paris, France

Olga Fuentes
Deputy Chairman of Regulation
Superintendence of Pensions, Chile