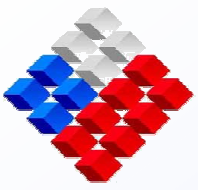


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THE CHILEAN PENSION SYSTEM

***SPEAKER: Mr. ALEJANDRO FERREIRO Y.
CEO
SUPERINTENDENCE OF PENSION FUNDS ADMINISTRATORS
CHILE***

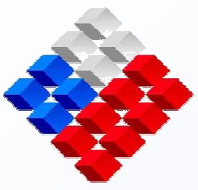
March 2002



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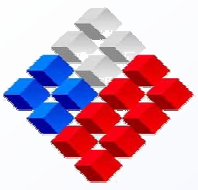
- ➔ **WHY CARRY OUT A REFORM?**
- ➔ **UNDERLYING BASIS OF THE REFORM**
- ➔ **CHARACTERISTICS OF THE SYSTEM**
- ➔ **TRANSITION STAGE**
- ➔ **EVOLUTION AND RESULTS**
- ➔ **MOST RECENT DEVELOPMENTS**



WHY CARRY OUT A REFORM?

— OLD, PAY-AS-YOU-GO SYSTEM EXPERIENCED A CRISIS WHICH MADE IT NECESSARY FOR A THOROUGH REVIEW OF THE APPROACH CHILE HAD TOWARDS SOCIAL SECURITY, AS THE SITUATION BECAME UNSUSTAINABLE IN THE LATE 70's:

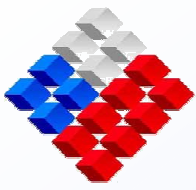
- » **FALL OF THE CONTRIBUTORS-PENSIONERS RATIO** (1960:10.8 to 1, 1980: 2.2 to 1)
- » **INCREASE IN EVASION OF PROVIDENT CONTRIBUTIONS** (1976: pension and health contributions surpassed 50%)
- » **PERMANENT FISCAL INPUT** (1965-1980: the State financed, on average, one third of the outflows of the Social Security System)
- » **ADMINISTRATIVE DEFICIENCIES INVOLVING THE SOCIAL SECURITY INSTITUTIONS** (Disparity of Institutions and the Schemes provided, Absence of Rational Administrative Procedures; Inequalities in the treatment of workers of a same condition/level)



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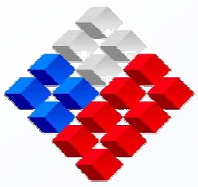
UNDERLYING BASIS OF THE SYSTEM

- ➔ **INDIVIDUAL CAPITALISATION**
- ➔ **PRIVATE ADMINISTRATION OF THE FUNDS: AFP**
- ➔ **FREE CHOICE OF AFP**
- ➔ **ROLE OF THE STATE**
 - » GUARANTEES BENEFITS
 - » SURVEILLANCE AND REGULATION



CHARACTERISTICS OF THE SYSTEM

- ➔ **SET CONTRIBUTIONS**
- ➔ **PATRIMONIAL SEPARATION BETWEEN AFP AND THE FUND**
- ➔ **MANDATORY SYSTEM FOR SALARIED WORKERS AND VOLUNTARY BOTH FOR SELF-EMPLOYED WORKERS AND FOR THOSE BELONGING TO THE OLD SYSTEM**
- ➔ **AFP ARE PRIVATE ENTITIES WITH A SOLE OBJECTIVE**
- ➔ **AFP CHARGE COMMISSIONS FOR MANAGING THE FUNDS**
- ➔ **MINIMUM CAPITAL REQUIREMENT**
- ➔ **AFP MUST MEET A MINIMUM YIELD REQUIREMENT, THERE IS A CASH RESERVE (1% OF THE FUNDS) TO MAKE UP A SAFEGUARD FOR MINIMUM YIELD**
- ➔ **CURRENTLY, THERE ARE 7 AFP IN THE INDUSTRY**



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CHARACTERISTICS OF THE SYSTEM

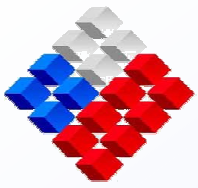
MAIN BENEFITS

➔ PENSIONS :

- » OLD-AGE
- » EARLY RETIREMENT
- » TOTAL AND PARTIAL DISABILITY
- » SURVIVAL

➔ PENSION MODALITIES

- » PROGRAMMED WITHDRAWAL
- » LIFE ANNUITY
- » TEMPORARY INCOME WITH DEFERRED LIFE ANNUITY



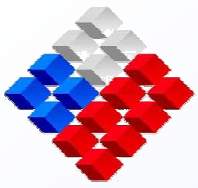
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CHARACTERISTICS OF THE SYSTEM

MAIN BENEFITS

➔ FINANCING OF PENSIONS

- » **Old-Age Pensions:** Individual Savings (10% of the salary) + Yield
- » **Disability and Survival Pensions:** Individual Savings (10% of the salary)+ Yield + Indemnification of the Disability and Survival Insurance (DSIP)
- » **State Warranty**

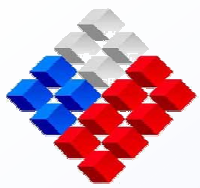


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CHARACTERISTICS OF THE SYSTEM

INVESTMENTS

- 1. ELIGIBLE INSTRUMENTS BY LAW**
- 2. RISK RATING**
- 3. INVESTMENT LIMITS**
- 4. AUTHORIZED MARKETS**
- 5. CUSTODY OF TITLES**

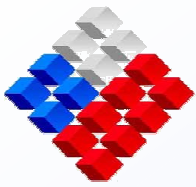


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CHARACTERISTICS OF THE SYSTEM

INVESTMENTS

- 6. REGULATION OF CONFLICTS OF INTERESTS**
- 7. MINIMUM YIELD**
- 8. APPRAISAL OF INSTRUMENTS**
- 9. INVESTMENT ABROAD**



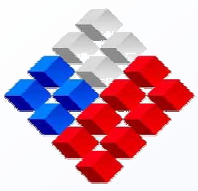
TRANSITION STAGE OF THE INDIVIDUAL CAPITALISATION SYSTEM

(1981 –2015)

1. FISCAL COST OF THE REFORM

**GENERATION OF PENSION DEFICIT DUE TO
AFFILIATE TRANSFER IN SYSTEMS. STATE
COVERED DEFICIT THROUGH:**

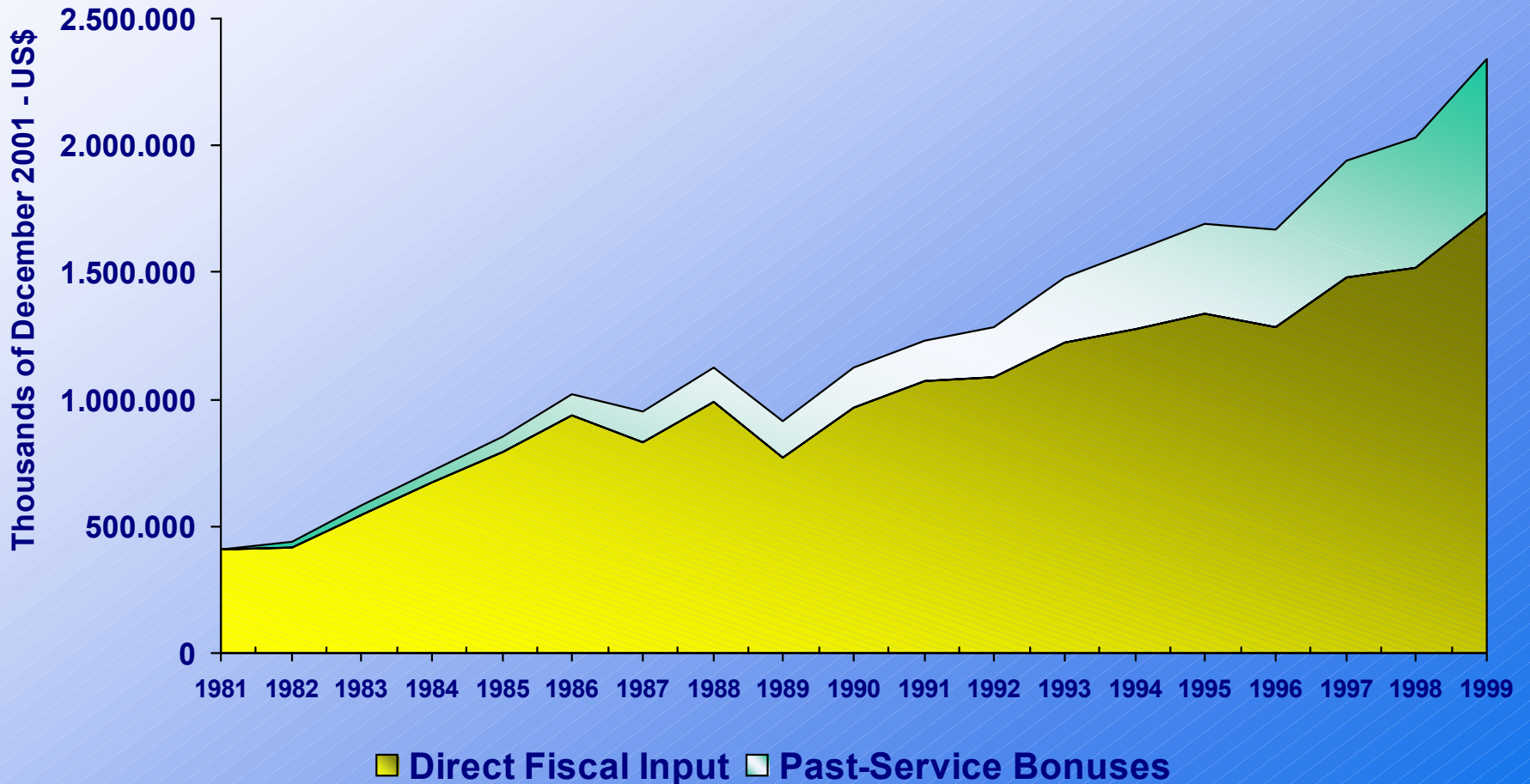
- ➡ **DIRECT FISCAL INPUT:** COVERS DEFICIT DUE TO PAYMENT OF PENSIONS BELONGING TO THE OLD SYSTEM
- ➡ **PAYMENT OF PAST-SERVICE BONUSES:** ACKNOWLEDGES CONTRIBUTIONS MADE INTO THE OLD SYSTEM FOR WORKERS WHO MOVED ONTO THE NEW SYSTEM

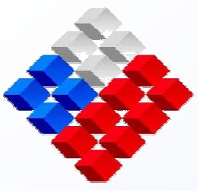


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TRANSITION STAGE OF THE INDIVIDUAL CAPITALISATION SYSTEM

COSTS OF THE REFORM

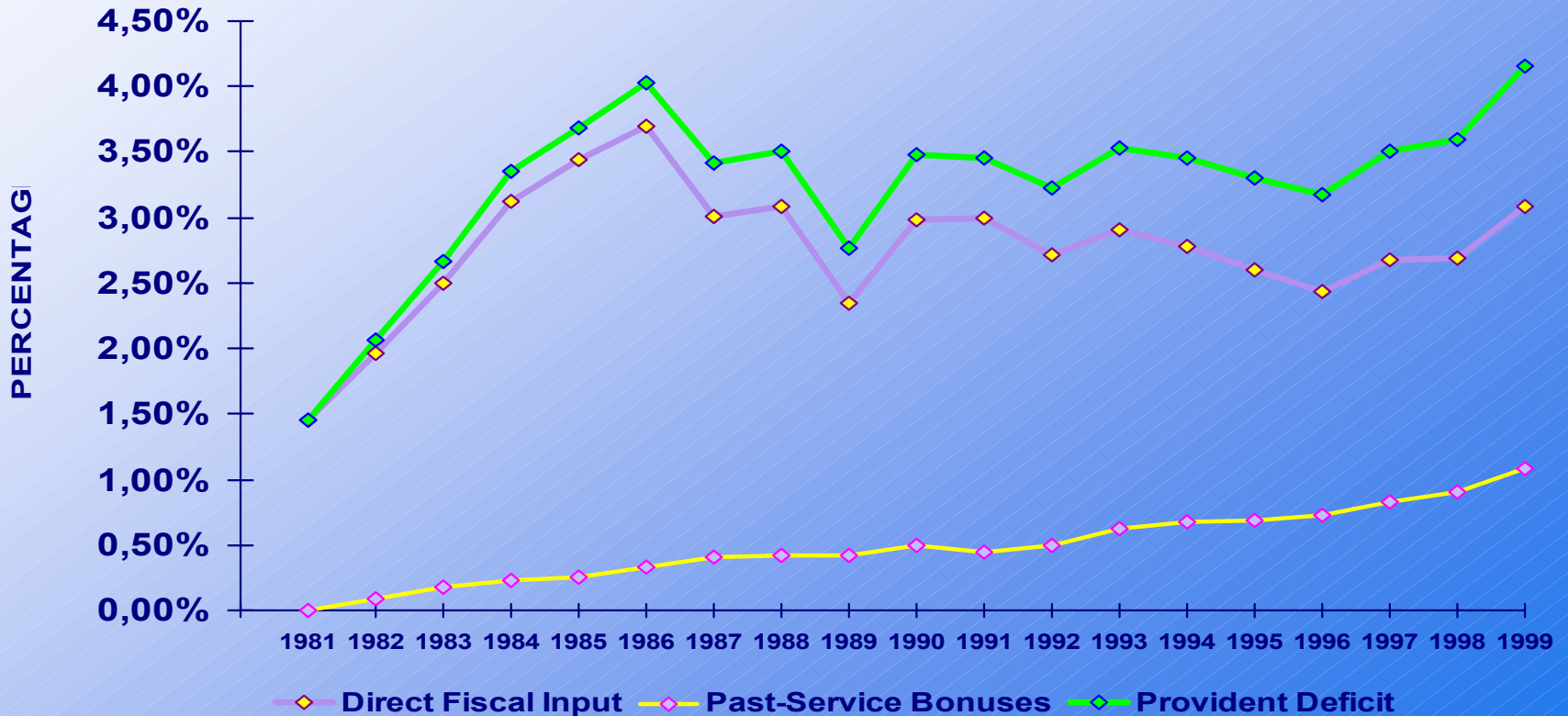


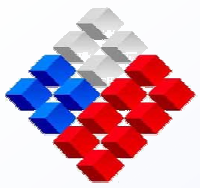


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TRANSITION STAGE OF THE INDIVIDUAL CAPITALISATION SYSTEM

COSTS OF THE REFORM AS AGAINST GDP

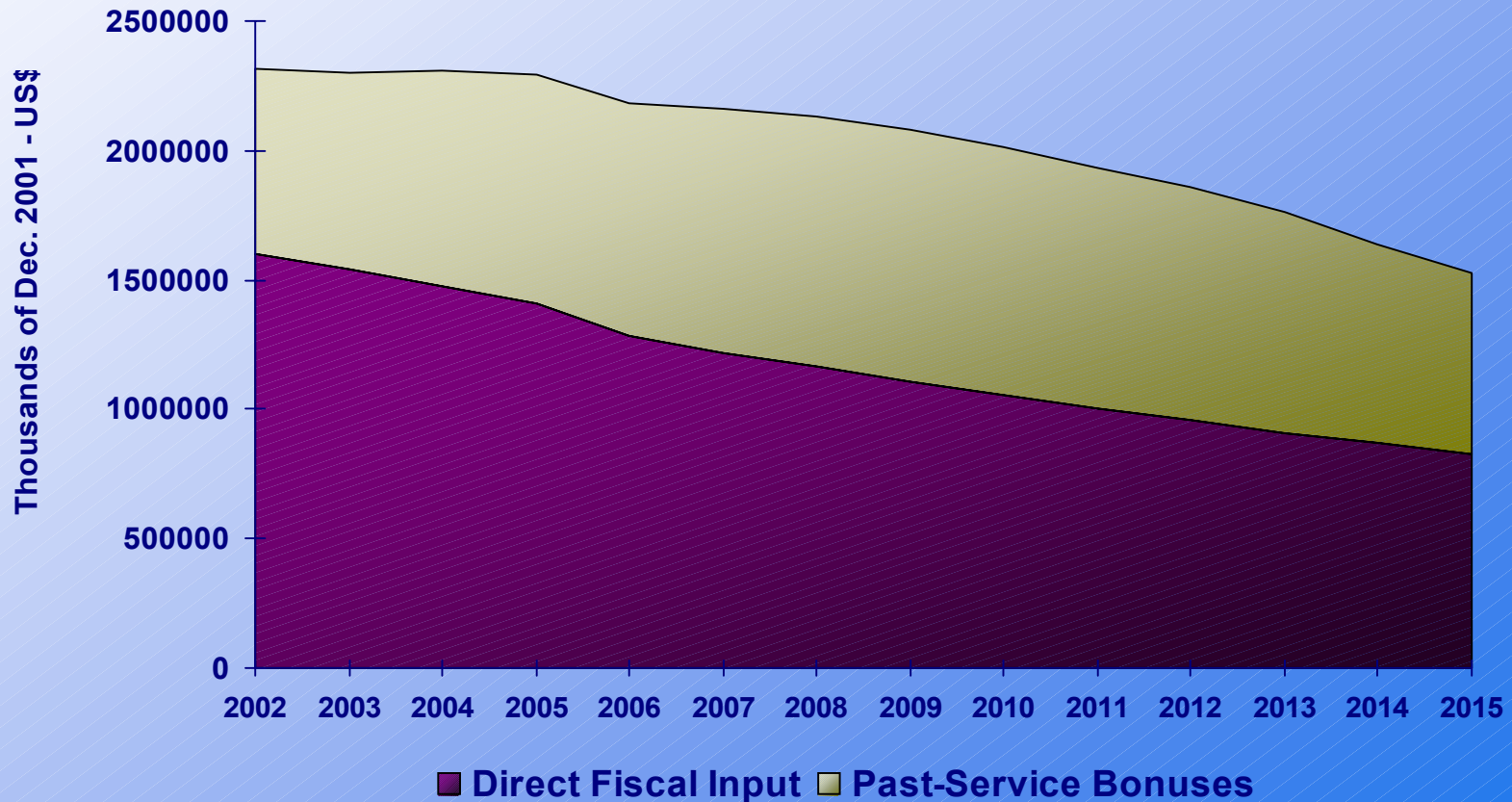


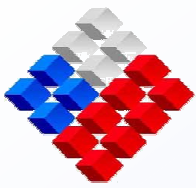


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TRANSITION STAGE OF THE INDIVIDUAL CAPITALISATION SYSTEM

PROJECTED COSTS OF THE REFORM

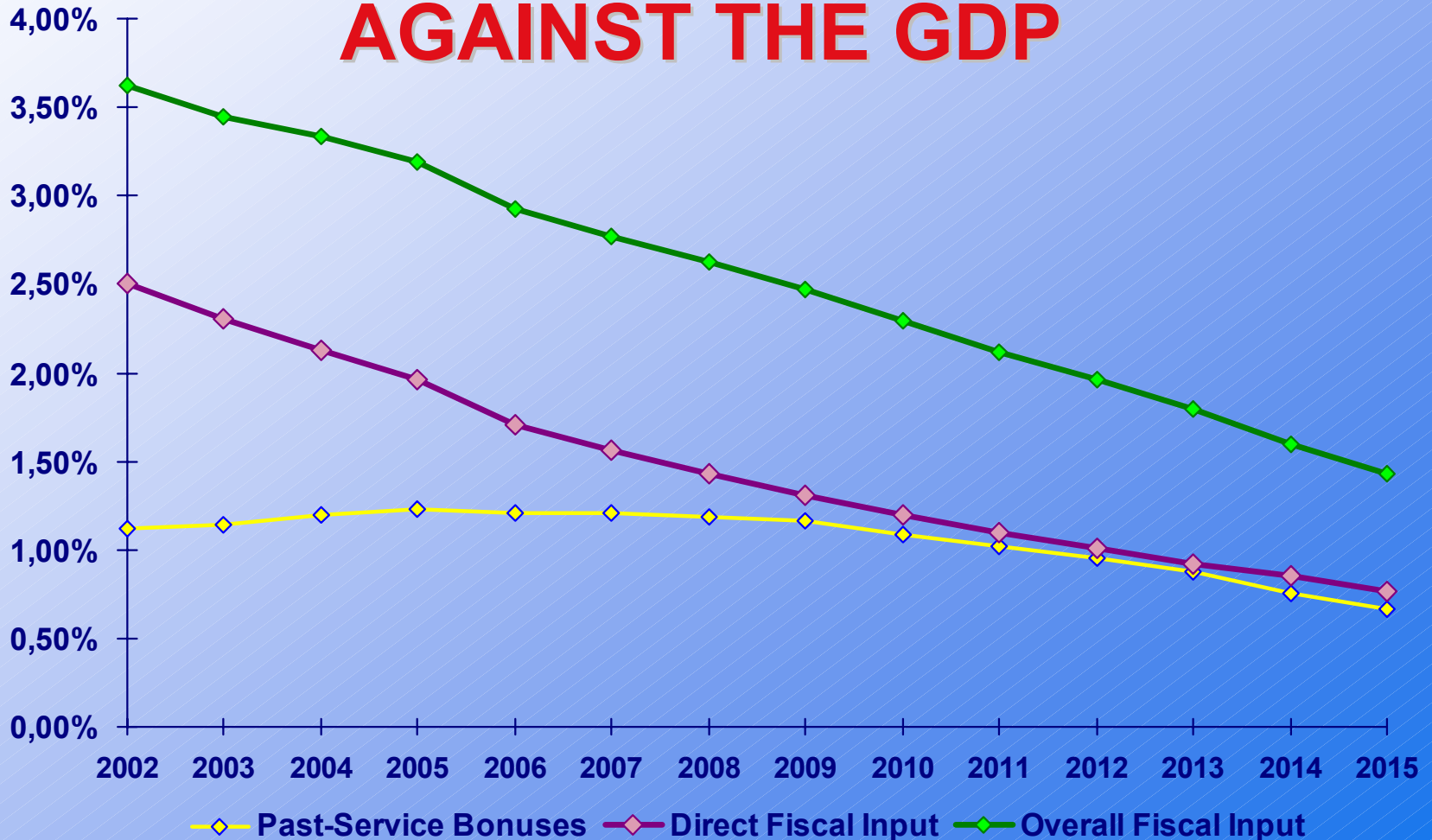


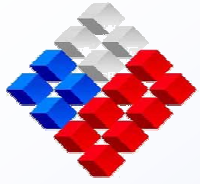


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TRANSITION STAGE OF THE INDIVIDUAL CAPITALISATION SYSTEM

PROJECTED COSTS OF THE REFORM AS AGAINST THE GDP

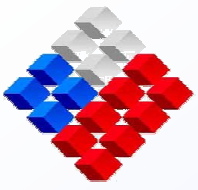




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DEVELOPMENT AND RESULTS

*Of the
Chilean Pension System*

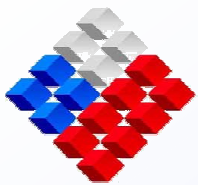


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DEVELOPMENT AND RESULTS OF THE SYSTEM

CONTRIBUTORS AND PENSION COVERAGE



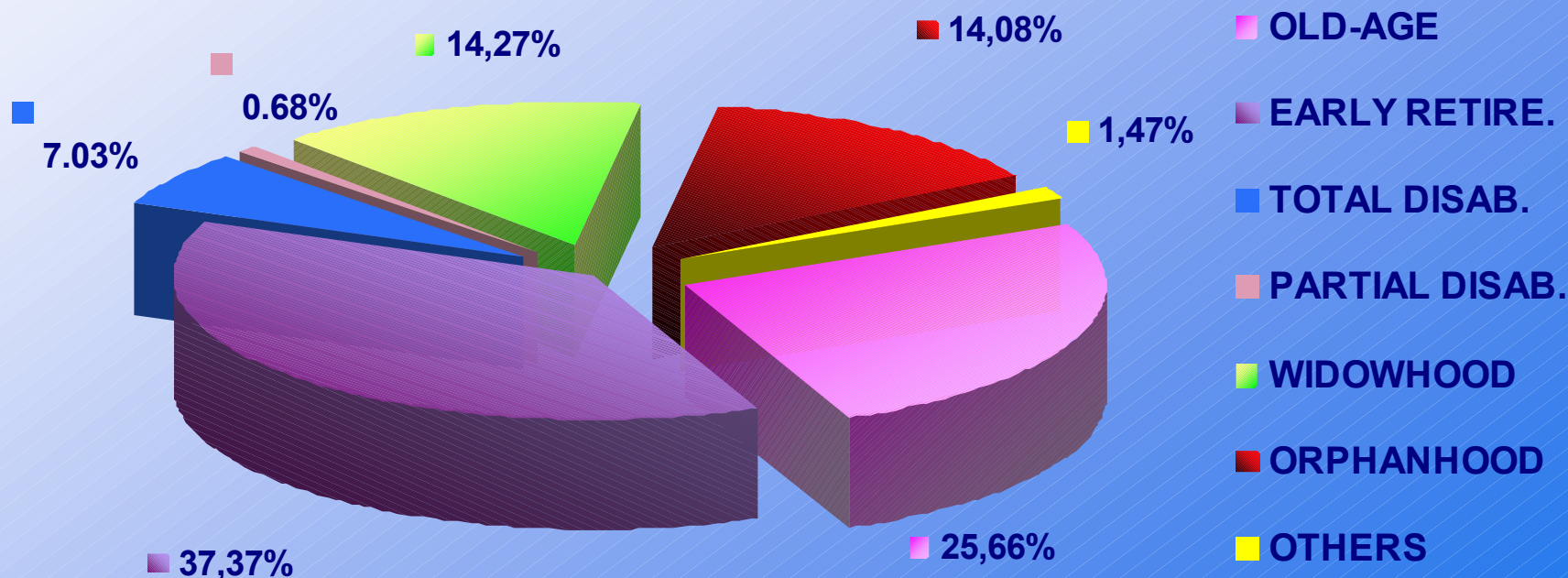


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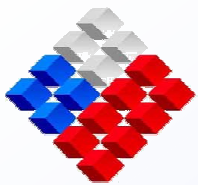
DEVELOPMENT AND RESULTS OF THE SYSTEM

PENSIONS PER TYPE⁽¹⁾

Up to November, 2001



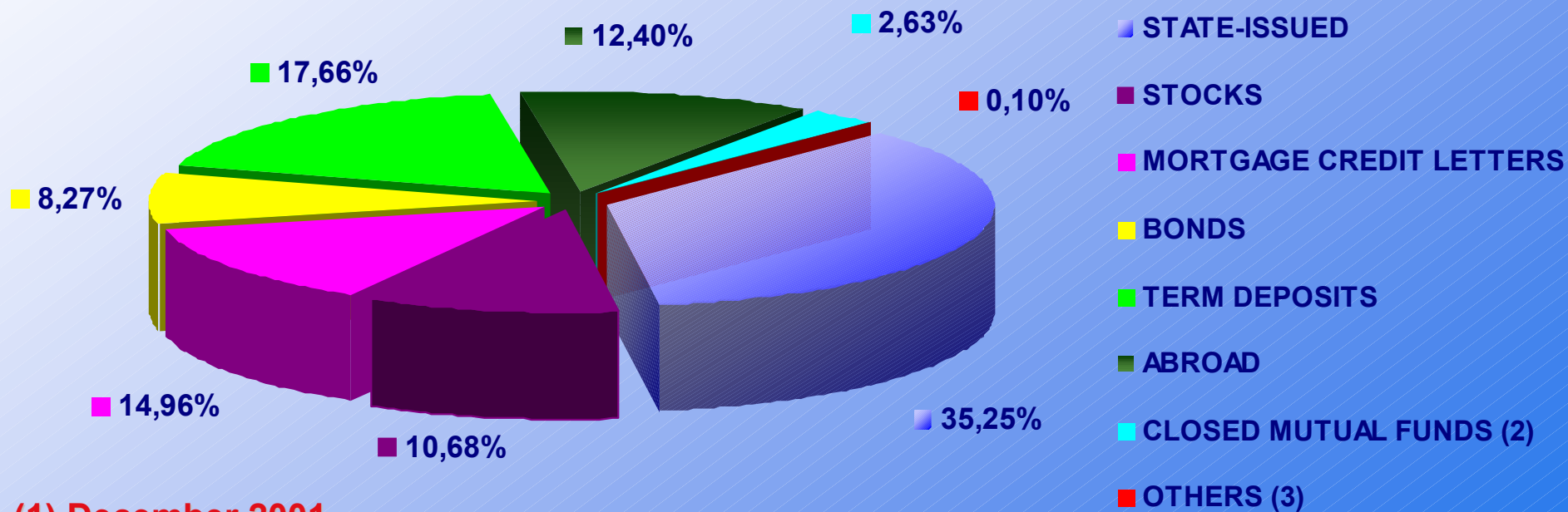
(1) The System records 397,082 pensioners



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DEVELOPMENT AND RESULTS OF THE SYSTEM

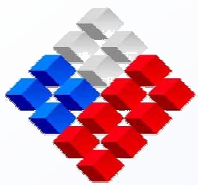
DIVERSIFICATION PER INSTRUMENT ⁽¹⁾



(1) December 2001

(2) Includes International Closed Mutual Funds

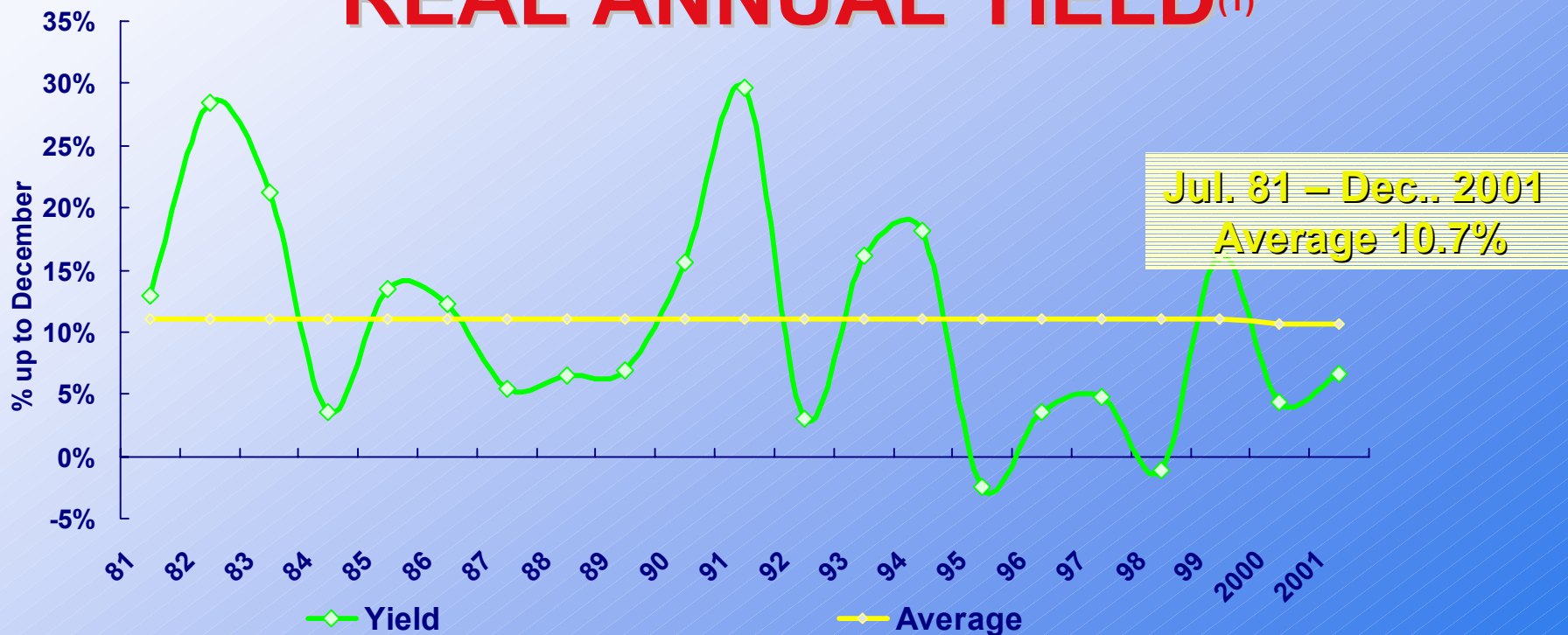
(3) Includes cash and hedging



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DEVELOPMENT AND RESULTS OF THE SYSTEM

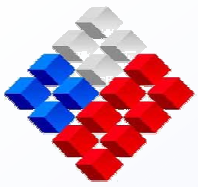
REAL ANNUAL YIELD⁽¹⁾



(1) UF- Deflated

(2) Yield obtained through a contribution, registered

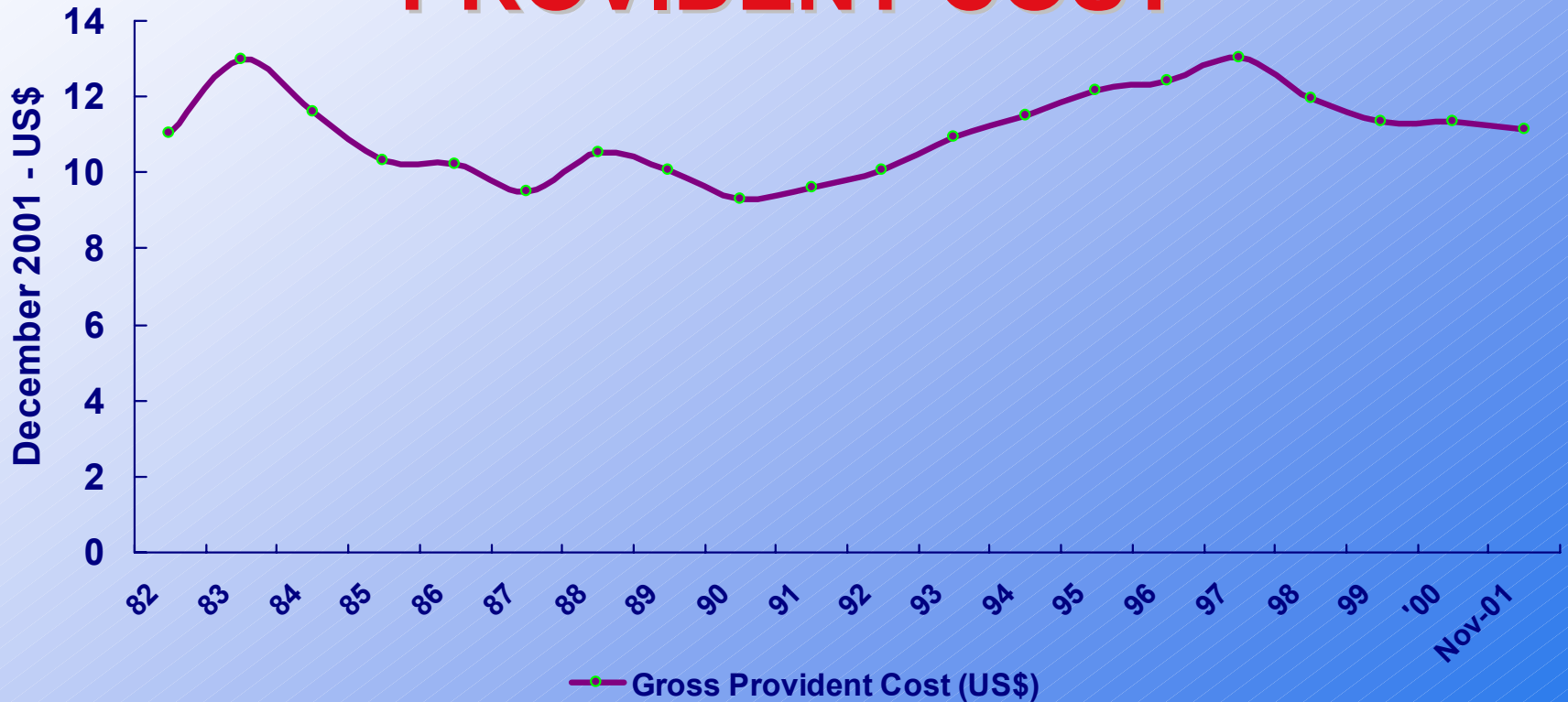
in June 1981, that stands in the System up until Dec. 2001

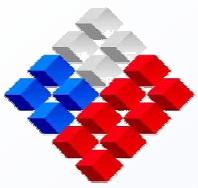


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DEVELOPMENT AND RESULTS OF THE SYSTEM

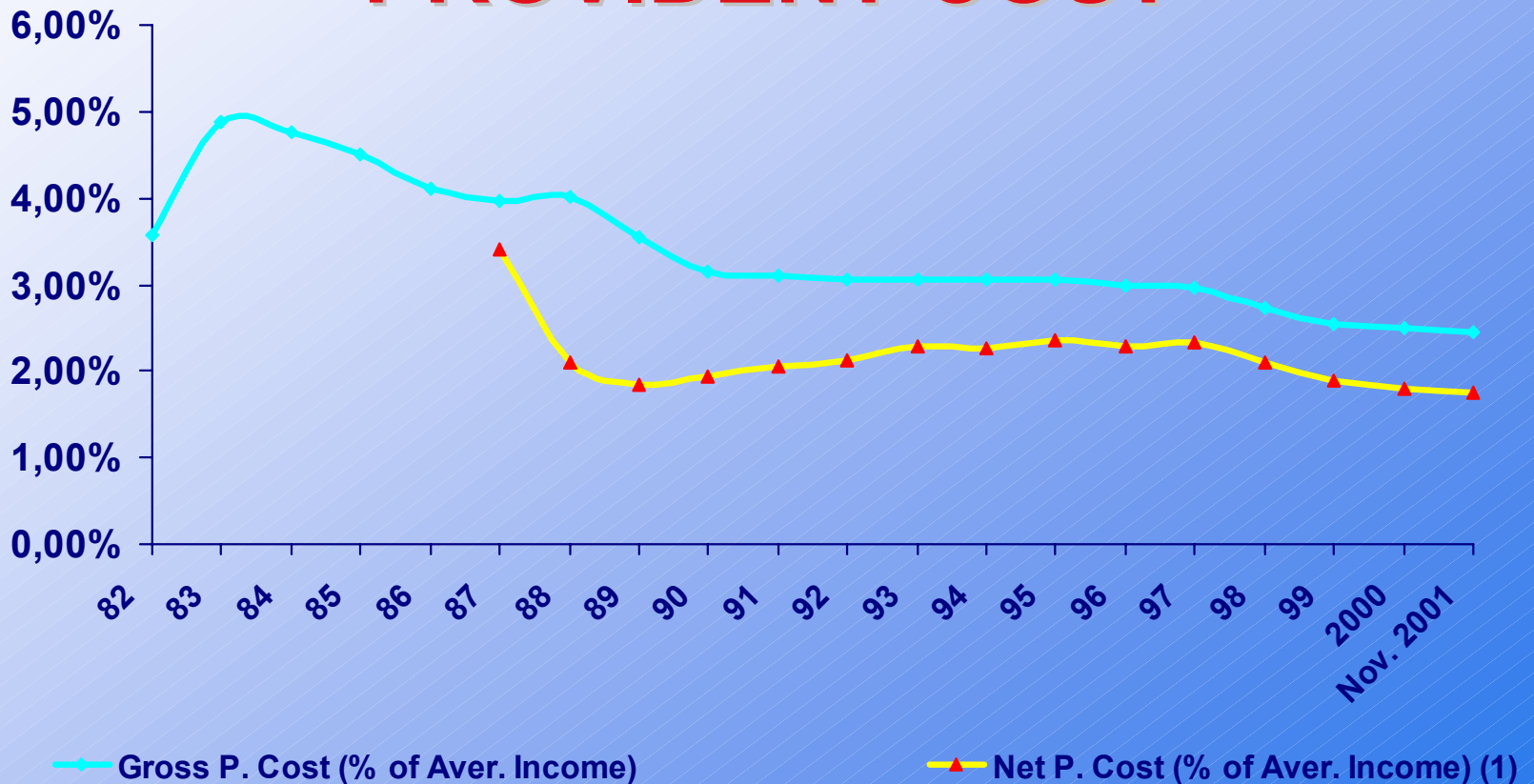
PROVIDENT COST



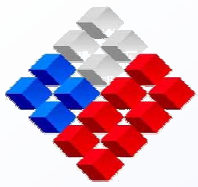


DEVELOPMENT AND RESULTS OF THE SYSTEM

PROVIDENT COST

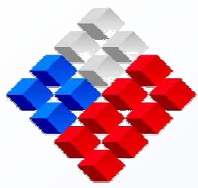


(1) Gross Prov. Cost minus the DSI premium



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THE CHILEAN PENSION SYSTEM: MOST RECENT DEVELOPMENTS



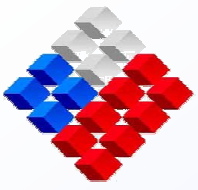
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MOST RECENT DEVELOPMENTS

A MULTIFUNDS SCHEME

➔ 3 MAIN AREAS OF DEVELOPMENT:

- 1. CREATION OF A MULTIFUNDS SCHEME MANAGED BY EACH AFP.**
- 2. ENHANCEMENT OF THE CURRENT STRUCTURE OF PENSION FUNDS INVESTMENTS ABROAD.**
- 3. ENHANCEMENT OF PENSION FUNDS DOMESTIC INVESTMENT**



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RECENT DEVELOPMENTS MULTIFUNDS

MULTIFUNDS SCHEME:

- ➔ *Increases the number of Pension Funds managed by each AFP, from the two current ones, to 5.*
- ➔ *These Pension Funds would differ from each other in terms of amount of variable income in the corresponding investment portfolio.*

The higher the share of variable income managed, the higher the risk involved.

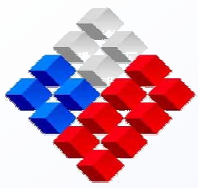


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RECENT DEVELOPMENTS

MULTIFUNDS

MULTIFUNDS SCHEME		
Type of Fund	Variable-Income Maximum Investment Limit (As a % of the Fund)	Variable-Income Minimum Investment Limit (As a % of the Fund)
Fund A	80%	40%
Fund B	60%	25%
Fund C	40%	15%
Fund D	20%	5%
Fund E	Unauthorized	Unauthorized



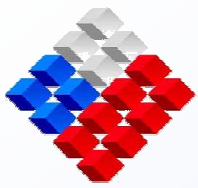
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RECENT DEVELOPMENTS

MULTIFUNDS

MUTLTIFUNDS SCHEME:

- ➔ ***Mandatory creation of the 4 Funds with less relative risk:*** must be installed simultaneously once the Law is passed
- ➔ ***Each AFP will be free to decide whether or not to provide Fund A as a choice for its affiliates:*** measure is aimed at lowering costs and, thus, making it more feasible for new competitors to enter the Industry



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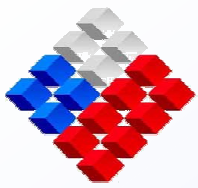
RECENT DEVELOPMENTS

MULTIFUNDS

MULTIFUND CHOICES FOR A NON-PENSIONED AFFILIATE⁽¹⁾

		Men and Women up until 35 years old	Men as of 36 years old, up until 55 years old Women as of 36 years old, up until 50 years old	Men as of 56 years old Women as of 51 years old
Investment Options	Fund A			
	Fund B			
	Fund C			
	Fund D			
	Fund E			

(1) With regard to compulsory contributions



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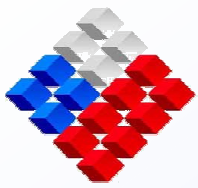
RECENT DEVELOPMENTS **MULTIFUNDS**

MUTLTIFUNDS SCHEME:

- ➔ In the *event an affiliate does not opt* for a specific Fund, the *Law consecrates a gradual allocation* of the former, transferring **20% of the balance** in his/her ICA on an *annual basis*, throughout a *5 year time-span*.

WHY?

To push mandatory allocation towards a portfolio sequence nearer to the optimum, thus limiting political and financial risk associated to abrupt scenario changes



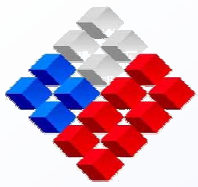
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RECENT DEVELOPMENTS

MULTIFUNDS

MANDATORY ALLOCATION OF AFFILIATES ACCORDING TO THE LAW

		Men and Women up until 35 years old	Men as of 36 years old, up until 55 years old Women as of 36 years old, up until 50 years old	Men as of 56 years old Women as of 51 years old
Investment Options	Fund A			
	Fund B			
	Fund C			
	Fund D			
	Fund E			



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RECENT DEVELOPMENTS

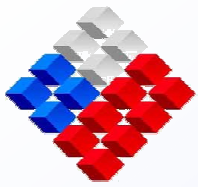
MULTIFUNDS

MULTIFUNDS SCHEME:

➔ *Free Balance-Transference Amongst Funds of:*

- Compulsory contributions
- Voluntary contributions
- Contracted Deposits
- Voluntary Savings Account

» When in the event of *more than 2 transfereces in a year*, SOME of these balances *pay* an *exit-fee* (avoidance of excessive operational costs and potential backfire on capital market)



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RECENT DEVELOPMENTS

MULTIFUNDS

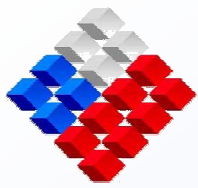
MULTIFUNDS SCHEME:

➤ *Allows for Individual Contracts Between AFP and Affiliate:*

- » To simultaneously allocate resources in two Funds.
- » To agree on future transferences of Funds

WHAT FOR?

To achieve a greater approach to each affiliate's risk/yield preference, taking into account his/her individual characteristics.



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RECENT DEVELOPMENTS

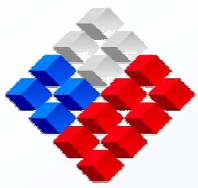
MULTIFUNDS

INVESTMENT ABROAD:

- ➔ **Sets** an **overall threshold for investment abroad** carried out with the resources managed by each AFP (i.e. with regard to Investments carried out by the 5 Funds as a whole)

WHY?

To free the portfolio manager to determine which is the optimal percentage of foreign investment for each of the Funds administrated.

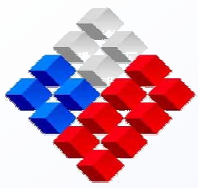


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RECENT DEVELOPMENTS MULTIFUNDS

➔ INVESTMENT ABROAD

NEW INVESTMENT LIMITS		
TIME-SPAN	NEW RANGE (AS OF ENFORCEMENT OF LAW)	
	Range for Maximum Overall Limit	Range for Minimum Overall Limit
Up to 3 rd Month	20%	13%
4 th to 6 th Month	20%	15%
7 th to 12 th Month	20%	Sub-limit is eliminated
13 th to 24 th Month	20% - 25%	Sub-limit is eliminated
As of 25 th month	20% - 30%	Sub-limit is eliminated



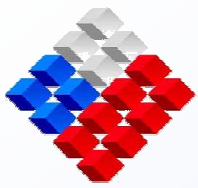
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RECENT DEVELOPMENTS

MULTIFUNDS

WHAT IS EXPECTED FROM THIS AMENDMENT?

- ➔ **An increase in the overall level of Pension Amounts**
- ➔ **To broaden the investment portfolio options, granting a choice in accordance to risk/yield preferences.**
- ➔ **Achieving a better allocation of resources**
- ➔ **Granting incentives to the search for information**
- ➔ **To enhance the service already rendered by AFPs**
- ➔ **Deeper involvement on the part of affiliates**



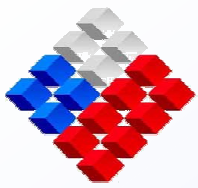
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RECENT DEVELOPMENTS MULTIFUNDS

WHAT IS EXPECTED FROM THIS AMENDMENT?

➔ Increase in Pension Amounts:

- » Investing in a portfolio that presents a *risk* which is *linked to personal investment horizons allows for a raise in* the expected value (*amount*) *of* the *pension* to be obtained.
- » A *higher expected pension value enables a greater efficiency in* the *System's cornerstone*: to grant its affiliates a pension that allows for an *adequate income replacement rate*.



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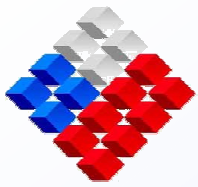
RECENT DEVELOPMENTS

MULTIFUNDS

WHAT IS EXPECTED FROM THIS AMENDMENT?

➔ Increase in Pension Amounts:

- » ***Estimates conclude that different investment portfolio options throughout working life enable an accrument of a higher balance in the Individual Capitalization Account (ICA), therefore, resulting in a higher pension***
- » ***Case study utilised historical yield data to simulate de end-balance a worker would accrue in his/her ICA, under Multifunds scenario, towards the end of his/her working life, to then compare it with the current situation.***
- » ***200 yield simulations for each of 2 definitions of Affiliate: Pasive and Active***



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RECENT DEVELOPMENTS

MULTIFUNDS

➔ Increased Pension Amounts – An Estimate:

» **Active Affiliate:**

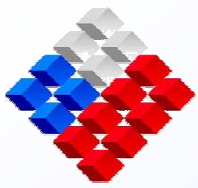
- Risk Prone
- Exercises the right to choose and transfer between Funds
- 30 years in Fund A (From 25 up until 55 years old)
- 10 Years in Fund C (From 56 up until 65 years old)

» **Passive Affiliate:**

- Does not use his/her possibility of choosing the Fund
- His/her savings are assigned to the corresponding Fund as stipulated by the Law

» **Current Situation:**

- Affiliate remains in Fund C (similar to current Type-1 Fund) throughout his/her working life.



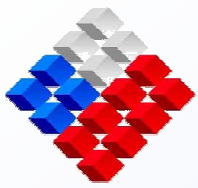
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SUPERINTENDENCIA DE AFP

RECENT DEVELOPMENTS

MULTIFUNDS

Increased Pension Amounts- An Estimate

Affiliate	Multifunds Scenario End-Balance > Two-Fund Scenario End- Balance (% of cases)	Two-Fund Scenario (Balance expected at the turning of legal age to be granted a Pension)	Expected Average Balance in a Multifunds Scenario (As a share of Two-Fund Scenario End-Balance in the ICA)
Active	100	100%	190.5%
Passive	69.9	100%	102.9%



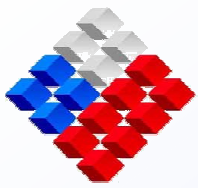
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RECENT DEVELOPMENTS **MULTIFUNDS**

WHAT IS EXPECTED FROM THIS AMENDMENT?

➔ **More Investment Portfolio Options**

- » *Implies granting a choice in accordance with risk/yield preferences.*
- » The latter is particularly relevant for *younger* segments of *affiliates*, whom *should have an option for a higher risk level and expected* return (*yield*)
- » By the same token, *older affiliates and pensioners should be allowed to opt for a minimum risk* Fund, with a lower expected return, so as *to minimize pension value fluctuations.*



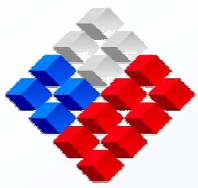
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RECENT DEVELOPMENTS MULTIFUNDS

WHAT IS EXPECTED FROM THIS AMENDMENT?

➔ A Better Allocation of Resources

- » A ***higher specialization*** in terms ***of investment strategies*** ***implies*** an increased efficiency in the allocation of the economy's resources with the ***consequential positive impact on*** the latter's ***growth rates***.



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RECENT DEVELOPMENTS

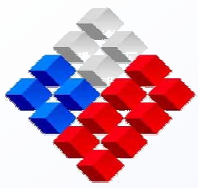
MULTIFUNDS

WHAT IS EXPECTED FROM THIS AMENDMENT?

➔ A Better Allocation of Resources

» Effect of a Multifunds Scheme on the Variable Income Portfolio of Pension Funds – Estimate

- **Scenario I:** 40% of affiliates choose one type of Fund and the remaining 60% is assigned as set forth by the Law.
- **Scenario II:** 10% of affiliates choose one type of Fund

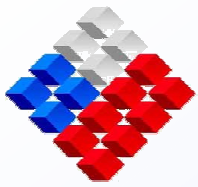


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RECENT DEVELOPMENTS MULTIFUNDS

WHAT IS EXPECTED FROM THIS AMENDMENT?

- ➔ **An Increased Search for Information and a Deeper Involvement on the Part of Affiliates, Leading to a Better Service and Overall Results**
 - » ***Greater options*** in terms of Funds available and returns expected from different levels of risk, ***demand well-informed choices*** regarding Pension Fund performance ***which***, in turn, should ***result in*** Affiliates exerting discipline on/demanding certain ***higher levels of responsibility and service personalization on the part of the Managers*** to which they confide their provident savings.



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