

# Retirement readiness: a challenge for pension systems in Latin America

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## Contents

### General context

Challenges

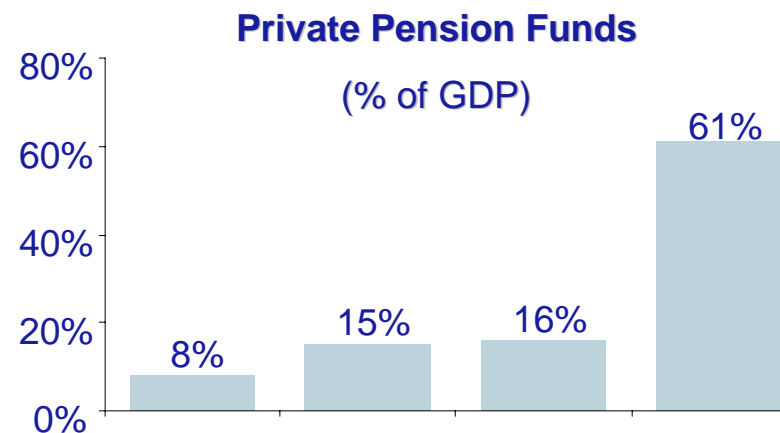
Retirement readiness: the critical cases

Retirement readiness: some preliminary numbers for the case of Chile

Conclusions

## General Context

- Latin American pension systems have had an adequate standing in order to reach specific goals (especially in Chile).
- The dimension of the system in terms of GDP is especially important in Chile
- The system has been providing attractive yields and demonstrating robust results in face of the problems caused by the current financial crisis



Source: BBVA research

	Mexico	Peru	Colombia	Chile
Private Schemes (years in existence)	13	16	15	29
Rate of Contribution	6.5%*	10%	11%	10%
Real Historical Return	6.4%	8.5%	10%	9%
Participation of the workforce in private funds	33%	22%	27%	114%

\* Does not include social contribution

## Contents

General context

## Challenges

Retirement readiness : the critical cases

Retirement readiness: some preliminary numbers for the case of Chile

Conclusions

## Present challenges

**However, significant problems still remain in the region**

Especially for low income groups

**•Longevity risks**

**•Financial risk (mitigated by the introduction of “multifunds”)**

**•The problem of informality and the lack of coverage.**

**•The problem of low contribution levels.**

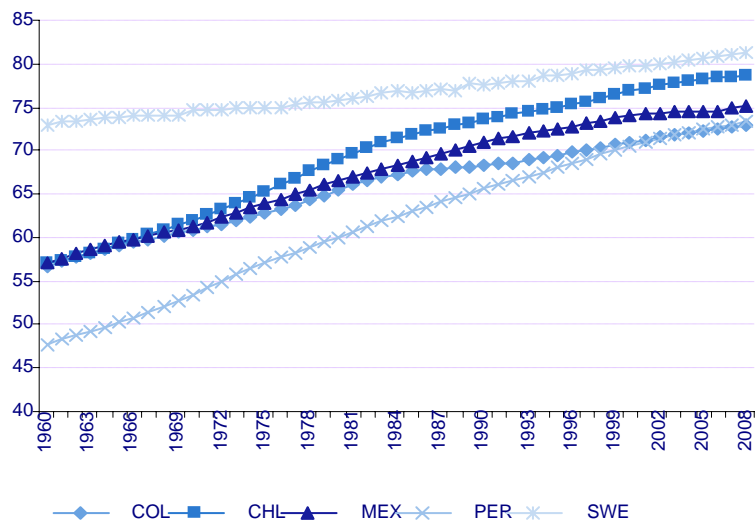


**High levels of poverty and exclusion may be exaggerated during the aging stage for many population segments in Latin America**

# Present Challenges

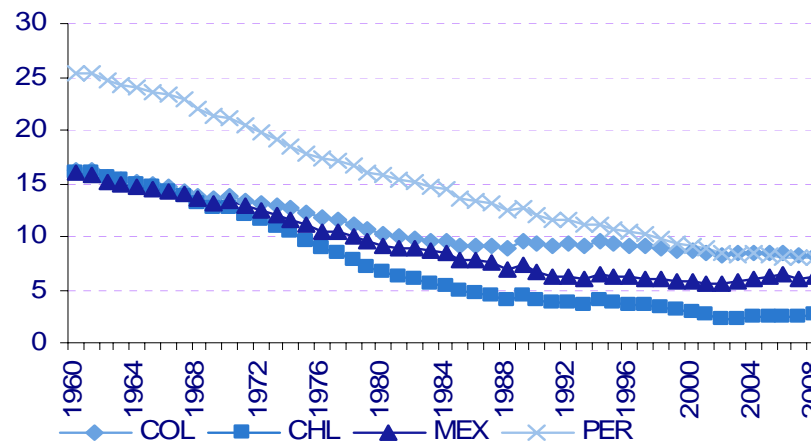
## Life expectancy and survival risk are increasing

Life expectancy (number of years)



Source: World Data Bank

Difference between Sweden and LATAM



Source: World Data Bank

Life expectancy has not stopped growing...

Observe the convergence of Life Expectancy of Latam with developed countries

## Contents

General context

Challenges

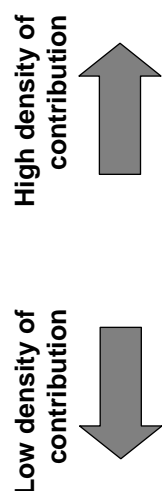
## Retirement readiness: some critical cases

Retirement readiness: some preliminary numbers for the case of Chile

Conclusions

## Retirement readiness: some critical cases

### Replacement rates: the case of Peru, Colombia and Mexico



Group	Replacement Rate 2050		
	Peru	Mexico	Colombia
A1	72%	48%	109%
A2	72%	38%	73%
A3	41%	26%	51%
B1	54%	40%	109%
B2	54%	32%	73%
B3	31%	23%	39%
C1	26%	27%	27%
C2	26%	21%	27%
C3	16%	15%	19%
D1	1%	9%	3%
D2	1%	7%	3%
D3	1%	6%	2%

**Group C and D, represent not less than 50% of population and not less than 40% in 2050**

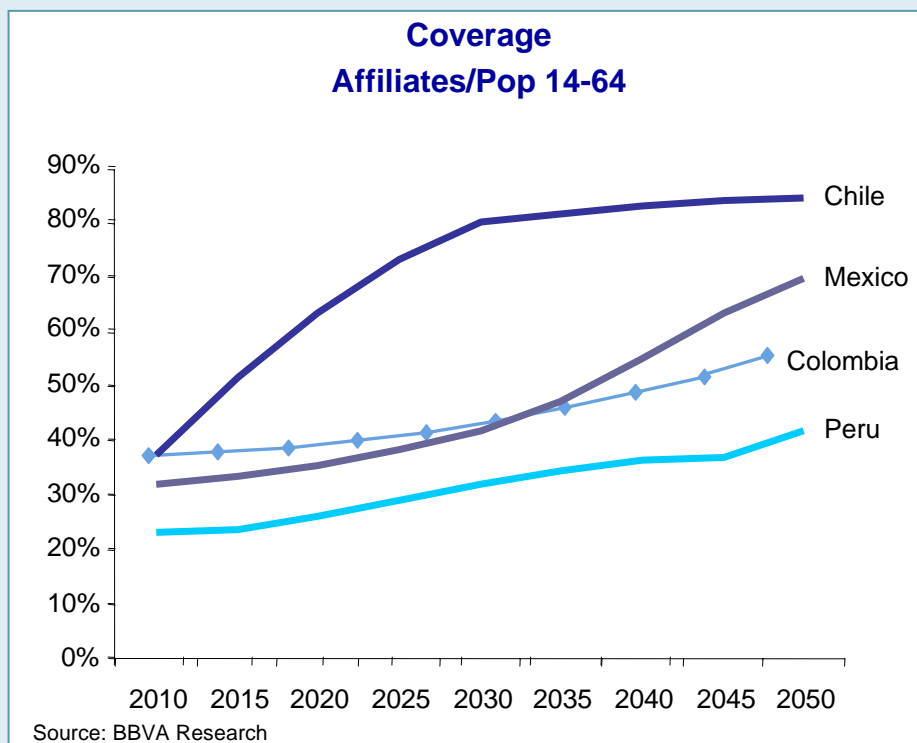
**Despite the pension systems funding efficiency, structural factors (poverty) conditioned low frequency of participation in pension systems .**

**As a consequence of that, replacement rates are very low in these three countries**

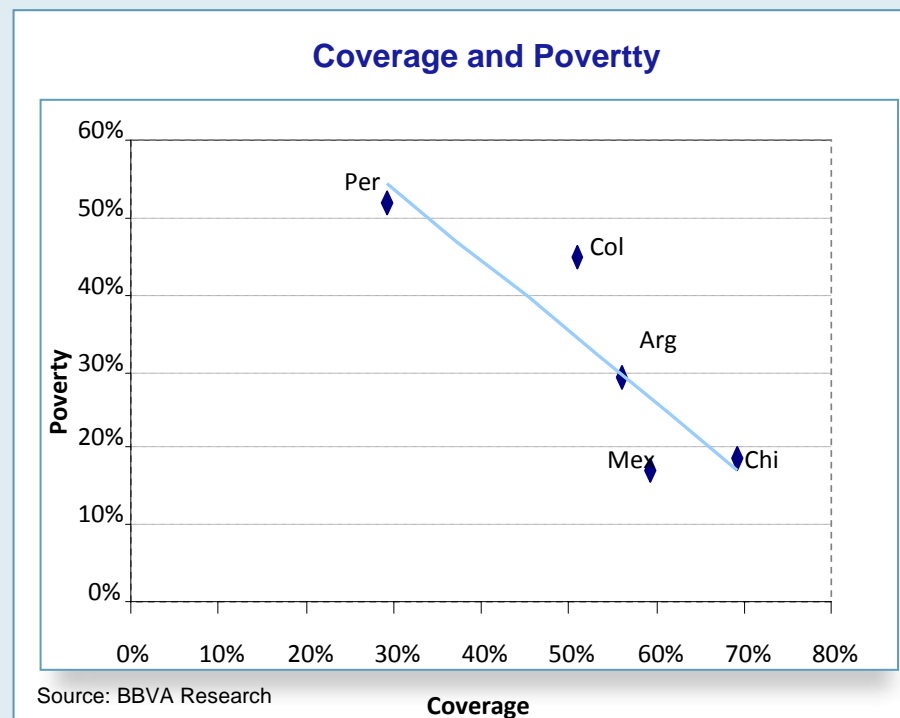


## Retirement readiness: some critical cases

**Low pension coverage, reflects enormous difficulties for the old age stage**



**Now, low coverage in Latam means that a big segment of population are not prepared for the old age stage.**



**Poverty and pension coverage are closely related. Only Chile is in a better position, so far.**

## Contents

General context

Challenges

Retirement readiness: the critical cases

**Retirement readiness: preliminary exercises for Chile**

Conclusions

## Retirement readiness: the case of Chile

### Looking at pensions and other assets ...

#### Chilean case: Average monthly pension and average monthly value of property (\$)

	PENSION	VALUE OF REAL ESTATE ASSETS
Quintile 1	118.56	24,684
Quintile 2	173.15	36,387
Quintile 3	225.12	36,667
Quintile 4	294.18	41,894
Quintile 5	760.87	78,322

Source: Social Protection Survey (2009)

At the present, many people who have a low retirement pension have another type of savings in real estate assets that would increase the level of income if it could be made liquid (reverse mortgage)

## Retirement readiness: the case of Chile

### Annuity simulation (preliminary exercises)

#### Assumptions for the Estimation of Lifetime Income

Sex ( M / F )	Male	Fund performance	5,00%
Initial age:	25 years	Annuity interest	3,60%
Age of retirement:	65 years	Annuity expenses	1,25%
Spouse age difference	3 years	Wage increase	1,0%
Contribution savings	0,1	Number of payments	12
Input frequency	12	Reversions to spouse	42%
Contribution density	0,8		
Commission s / flow	1,54%		

## Retirement readiness: the case of Chile

### Annuity simulation: 2010 (preliminary exercises)

	Total Pension	Salary	Replacement Rate	Starting Salary	Rate of Salary Growth	Capital Accumulated
Quintile 1	119	235	50,4%	158	1%	21579
Quintile 2	173	344	50,4%	233	1%	31785
Quintile 3	225	419	53,7%	304	1%	41408
Quintile 4	294	587	50,1%	398	1%	54239
Quintile 5	761	1472	51,7%	1027	1%	139972

	Total Pension	Salary	Replacement Rate	Starting Salary	Rate of Salary Growth	Capital Accumulated	Real Estate Value	Total Capital Accumulated
Quintile 1	218	235	93%	158	1%	21579	24.684	46263
Quintile 2	321	344	93%	233	1%	31785	36.387	68172
Quintile 3	375	419	89%	304	1%	41408	36.667	78076
Quintile 4	466	587	79%	398	1%	54239	41.894	96133
Quintile 5	1080	1472	73%	1027	1%	139972	78.322	218294

## Retirement readiness: the case of Chile

### Annuity simulation: 2050 (preliminary exercises)

	Total Pension	Salary	Replacement Rate	Starting Salary	Rate of Salary Growth	Capital Accumulated
Quintile 1	164	348	47,2%	236	1%	32128
Quintile 2	242	512	47,2%	347	1%	47324
Quintile 3	315	667	47,2%	452	1%	61652
Quintile 4	413	874	47,2%	593	1%	80755
Quintile 5	1065	2255	47,2%	1530	1%	208399

	Total Pension	Salary	Replacement Rate	Starting Salary	Rate of Salary Growth	Capital Accumulated	Real Estate Value	Total Capital Accumulated
Quintile 1	305	348	88%	236	1%	32128	36.751	68879
Quintile 2	449	512	88%	347	1%	47324	54.175	101499
Quintile 3	524	667	79%	452	1%	61652	54.593	116244
Quintile 4	652	874	75%	593	1%	80755	62.375	143129
Quintile 5	1512	2255	67%	1530	1%	208399	116.611	325010

## Contents

General context

Challenges

Retirement readiness: the critical cases

Retirement readiness: preliminary exercises for Chile

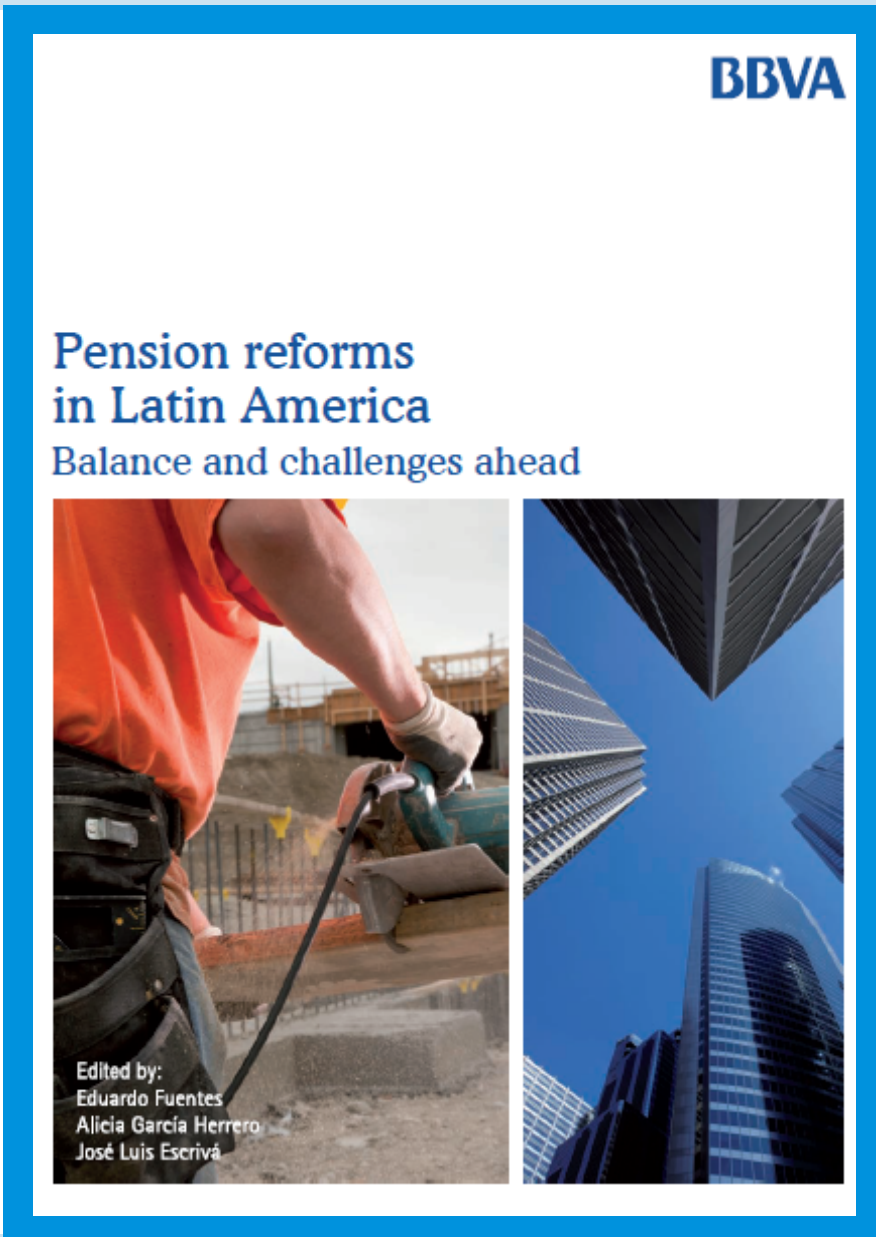
## Conclusions

## Conclusions

- 1. Latin American countries have serious problems to overcome, in order to provide adequate pensions for the old age stage. A good economic model, combined with adequate social protection policies will be fundamental.**
- 2. Chile is clearly an exception in the region. Good policies and an important pension reform -almost to be 30 years- provide very reasonable replacement rates.**
- 3. Some challenges for the global society in the future, such as longevity risk could undermine actual replacement rates. Considering past situations of higher life expectancy ratios, than previous forecasted, give us a clue of the future situation.**
- 4. In the case of Chile, it is observed that real estate assets could be an interesting way to reduce any gap that higher life expectancy could produce.**
- 5. This means that is necessary to think about products such as reverse mortgage. It is a lesser known financial product among the population, there is usually little competition of supply, and some countries that tried to implement it has faced some problems.**
- 6. The current situation of falling real estate prices is maybe not conducive to the development of reverse mortgages in some countries. However, in the medium and long term they still have a great deal of potential.**



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