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RESERVE  
BANK  
*of* ATLANTA

## **The Effect of the Privatization of Pension Plans on Financial and Regulatory Systems in Latin America**

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**This overview was compiled from publicly available information and does not reflect the views of  
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## INTRODUCTION

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The purpose of this paper is to look at the privatization of pension systems in Latin America and such privatization's effect on the financial and regulatory systems of the countries that have embraced it.<sup>1</sup> The paper opens with a brief overview of public and private pension fund management models, looks into the most common macroeconomic factors that fostered the privatization of the public pension model in the region, and presents various arguments regarding the degree of success of the pension reforms. The paper also discusses recent and proposed modifications to the various pension systems in the region and highlights some of the main issues for countries considering the privatization of their pension systems. This paper concludes that, although long-term credibility is yet to be established and further fine-tuning of individual models will continue in the short- to medium-term, in general, the privatization of pension systems has contributed to the region's economic stability over the past few years and has influenced the maturing of the financial and regulatory systems of the countries involved.

## EXECUTIVE SUMMARY

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In the '80s and '90s, traditional public pay-as-you-go (PAYGO) pension schemes in Latin American countries were plagued with political risk and macroeconomic weaknesses. Problems included poor handling of the funds by the state, conflict of interest in the government's role as administrator and supervisor of the plans, and dependency on intergenerational subsidies. This environment placed governments in the quandary of either reducing pension benefits - a politically unacceptable option in most cases - or increasing payroll taxes - an option that encourages tax avoidance and could be a disincentive to individuals to work and employers to hire.

In contrast, the privatization of the pension system or the "multi-pillar approach,"<sup>2</sup> introduced in Chile in

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<sup>1</sup> For the purpose of this paper, privatization of the pension system refers to the introduction of a private component into a country's pension system whereby individuals have the option to contribute to mandatory and/or voluntary private savings accounts from which they can gradually withdraw after retirement or trade in for an annuity.

<sup>2</sup> Most reformed pension systems in Latin America follow the World Bank's strategy based on a multi-pillar system where a publicly mandated and administered first pillar is retained or restructured, operated as a PAYGO system. A second pillar is added where publicly mandated, but privately administered individual retirement accounts are funded with defined contributions and

1981, offered the promise of faster economic growth by reducing fiscal expenses, potentially increasing national savings rates, and deepening local capital markets. More than two decades later, the Latin American experience, although far from ideal, holds valuable lessons for developed and emerging countries alike. Twelve countries in the region have implemented some type of structural changes to their national pension systems, with encouraging results in the areas of improved fiscal budgets, broader access to pensions for the total population, and increased savings and investments. However, in the interim, it has become clear that further reforms are needed to encourage greater participation in the plan and to prevent old age poverty for some segments of the population. Furthermore, experts continue to differ in their views of the degree of success across the region regarding improved domestic savings growth, deepening of local capital markets, and real enhancements to the legal and regulatory frameworks.

This paper provides data and discussions on both sides of the arguments surrounding the potential benefits of the privatization of pension plans. It concludes by acknowledging the overall positive effect of the privatization of pension systems in the region, while recognizing the need for further policy changes and adjustments. Moreover, this paper recognizes the reality of political and sovereign risk, which is inherent in even the best intentioned private pension system because of the limitations presented by each country's fiscal situation and macroeconomic constraints.

## PUBLIC vs. PRIVATE PENSION SYSTEMS

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Public pension systems of defined benefits, also known as the traditional PAYGO systems, work on the premise of intergenerational subsidies, whereby pensions paid to the elderly today are financed by taxes contributed by current workers, in exchange for tomorrow's workers financing current workers' pension benefits. Conversely, the original goal of pension reform in Latin America was to gradually downsize the public component of the pension system, while introducing mandatory private individual savings accounts and voluntary private pension accounts, thereby creating a multi-pillar pension system. Under the private model, publicly mandated, but

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managed by private pension fund administrators. Reformers have tried to increase retirement savings by defining incentives through regulation of a third pillar of voluntary retirement savings accounts arranged privately between employers and their workers. Current pension studies recommend the addition of *Pillar Zero*, or a *poverty prevention pillar*, referring to a government's minimal safety net to insure against poverty at old age.

privately administered defined contributions are held in individual retirement savings accounts and managed by private pension fund administrators or AFPs as they are known in most of Latin America. AFPs invest the funds in bonds and equities, while the state's role is reduced to enforcing the mandate, regulating the AFPs, and guaranteeing a minimum income to prevent old age poverty. Recent modifications to the private model encourage the increase of retirement savings through additional voluntary savings accounts arranged privately between employers and their workers, much like 401(k) accounts in the U.S.

### **WHY PENSION REFORM IN LATIN AMERICA?**

Prior to the pension reform introduced in Chile in the '80s, most countries in the region that had a pension plan relied exclusively on the PAYGO model. However, the PAYGO system was undermined by severe weaknesses, including the vulnerability of the system to political influences, the lack of transparency, and the inequality of the system, which distributed higher benefit to the members of certain sectors, such as the military and diplomats, at the expense of the rest of the population.<sup>3</sup> Furthermore, the system became harder to sustain within the fiscal budget as the number of active workers dropped relative to the number of retirees (dependency ratio).

Chile was the first country in the region to privatize its pension system in response to this state of affairs and to reduce the country's fiscal deficit. In return, the country achieved not only its initially stated goals, but other less predictable benefits, such as: a) the deepening of the local capital markets; b) the modernization of the financial and regulatory systems; and c) the creation of an entirely new supporting industry.

Encouraged by Chile's success, seven other countries in the region adopted some type of defined-contribution reform in the 1990s in response to potential or actual fiscal crises. These countries included Perú (1993), Colombia and Argentina (1994), Uruguay (1996), Mexico (1997), and El Salvador (1998). Costa Rica introduced voluntary retirement accounts in 1996 and made private individual retirement saving mandatory as a complement to the defined benefit system in 2000, while Nicaragua and the Dominican Republic introduced pension reforms in 2001. However, the Dominican Republic's new system became effective only in 2003, and Nicaragua postponed privatization indefinitely because it was expected to be too costly and to benefit only a small percentage of the

population.<sup>4</sup> Bolivia, Ecuador, Panama, and Uruguay, have made some progress with pension privatization, but not sufficient to be considered reformed. A decade later and more than 20 years later for Chile, the Chilean experience is by far the most successful, although positive developments are present in various degrees in the other countries with "reformed" systems regardless of whether the public pension was fully privatized or a private pension option was added to the public model.

### **DEVELOPMENTS IN THE FINANCIAL SECTORS**

Within the region, Chile's pension model has achieved the most success, credited by pension experts to the presence of various positive factors at the time the pension reform was introduced, including controlled inflation, the financial condition of the public sector, the introduction of banking reforms and regulations after the crisis of the '80s, and a government deposit guaranty scheme. Nonetheless, it is hard to ignore the potential benefits that privatization of the pension plan can offer if its basic elements are analyzed closely. Pension funds, whether under a public or private system, are generally a means to accumulate assets to cover or provide collateral for pension benefits at a later time. Under the multi-pillar model, the AFPs function as institutional investors involved in the management of individual contractual savings in the form of pension funds that are invested mainly in the local capital markets. These contractual savings are one key element applied to measure the development of capital markets in reformed countries because institutional investors managing these long-term assets provide liquidity and stability to capital markets, extend the maturities of corporate and government debt, contribute to the creation of new investment instruments, and encourage the improvement of capital markets infrastructure and corporate governance.

*The effect on domestic savings growth.* The actual growth and effect on domestic savings in the financial systems of economies where pension plans have been reformed is an ongoing argument at the heart of most pension reform assessments. In this regard, it is important to realize that while domestic savings refers to the combination of contractual and regular household savings, the true contribution of privatization is on the side of contractual savings growth. Contractual savings are long-term liabilities held mainly by AFPs, and regular savings are held by traditional financial institutions as short-term liabilities. Additionally, contractual savings are relatively

<sup>3</sup> A characteristic that continues to plague most pension plans in the region, but more markedly the models implemented in Colombia and Perú.

<sup>4</sup> See Appendix A for pension systems details for each country.

illiquid, more stable, and less exposed to systemic risk compared with regular savings, which are basically more liquid, less stable, and more vulnerable to systemic risk.

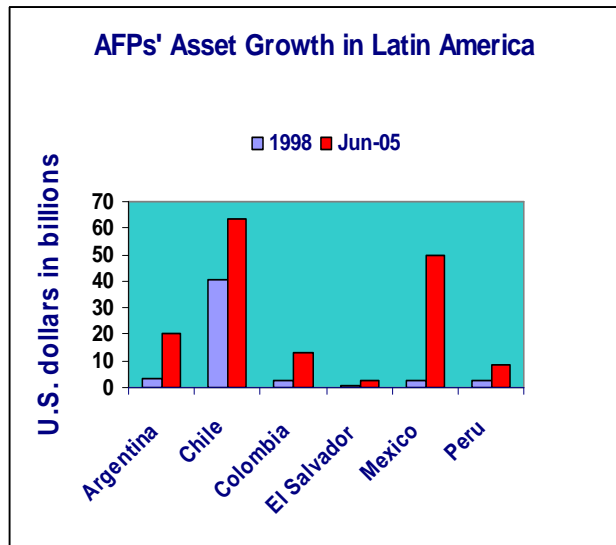
Discrepancies among pension analysts arise when some argue that an increase in a country's total savings occurs only during the initial funds build-up period of the fully funded plan model and that in a mature pension system, workers' contractual savings will be matched by payments to retiring workers, while others contend that the growth of contractual savings has a potentially more lasting effect on total domestic savings because the tax incentives<sup>5</sup> embedded in mandatory pension plans lure low-income workers who might not otherwise have saved. Further, contractual savings generally yield a higher rate of return, encourage higher aggregate savings, and increase financial independence of future generations because these savings are transferable at the time of the individual's death.

The region's experience with privatized pension plans is still considered too new to arrive at a definitive assessment. However, studies recently released by the World Bank indicate that pension fund assets (mandatory and voluntary individual retirement accounts) in the region have almost doubled as a percentage of GDP between 1998 and 2002, with Chile leading the region at 56 percent of GDP. A study conducted by JP Morgan on the subject and released in October 2004, supports these statistics, with assets managed by AFPs in Colombia and Perú reaching 9 percent and 11 percent of GDP, respectively, since reforms were introduced, notwithstanding that the public segment of the mixed pension model of these two countries continues to undermine their fiscal budgets.<sup>6</sup> Assets managed by Mexico's AFPs rose 20 percent in 2004 to \$43.2 billion despite a year of modest local job growth, and another 15 percent to \$49.4 billion through June 2005. Currently, Mexico's pension system is considered the best performer in the region and is on its way to become the most advanced due to recent regulatory changes.

**The effect on local capital markets.** AFPs have become a formidable force in some of the countries in the region as they are by far the dominant local institutional investors. In Chile, AFPs hold 40 percent of government bonds, 50 percent of mortgage bonds, 38 percent of corporate bonds,

5 The tax treatment of different forms of savings and investments are a key factor in the evolution of any financial system.

6 In Colombia, the public pension system coexists with the private pension fund and provides a very generous plan for certain public employees, while in Perú, the reformed pension system retained two types of public regimes that demand significant public subsidies.



Source: Federación Internacional de Administradores de Fondos de Pensions (FIAP).

and 35 percent of time deposits.<sup>7</sup> The overall effect of contractual savings in the development of local capital markets occurs as these savings shift from banks' short-term instruments to long-term, higher-yield securities investments. By encouraging the development or deepening of local capital markets, countries often realize a decrease in cost and an increase in the availability of equity and long-term debt financing for companies, which generally reduces dependency on foreign capital inflows and increases the country's GDP growth rates.

Nonetheless, some pension experts maintain that for this positive cycle to occur in the local capital markets, certain conditions have to be met, including: a) a stable macroeconomic environment; b) the early stages of robust and efficient capital markets; c) an adequate regulatory infrastructure and compliance with regulations to prevent undue risk taking and fraud; and d) safeguards to keep the government from using the pension funds for other fiscal necessities. Ironically, in the majority of countries in Latin America where a private pension model has been introduced, these conditions have developed or are developing as a consequence of pension privatization rather than as a prerequisite. Some analysts add that investments under the privatized model may yield significantly lower returns than government-managed social security; however, pension fund pools have the potential to diversify across assets and are less likely to be misused by corrupt or inefficient governments, although such pools are not completely isolated from sovereign

7 IMF. Consultation with Chile. August 2004.

risk.<sup>8</sup> Unfortunately, pension funds in the region remain unduly exposed to sovereign risk by virtue of regulatory investment limits, which place ceilings on foreign holdings. This limitation often results in a concentration in government debt securities because the scarcity of domestic corporate issues.

***The effect on financial innovation.*** Countries undergoing pension reform are generally faced with the need to provide an efficient and reliable environment for pension fund management. As a result, most countries have seen an improvement in the functions the financial system fulfills, including improved accounting and auditing standards, the introduction of information disclosure requirements for corporations that wish to be listed in the local capital markets and the modernization of the risk management technology used to evaluate pension portfolios.<sup>9</sup> More recently, several countries in the region have evaluated their clearing and settlement systems, and safekeeping practices, to facilitate the efficient and safe exchange of assets, and prevent losses due to fraud or theft.

***The growth of a supporting industry.*** Lastly, the presence of a supporting industry or financial infrastructure in a country prior to the introduction of pension reforms is an ideal condition for the development of the new pension model. However, in Latin America, pension reform, with its increasing demand for capital market financing and institutional investors' need for information prompted the birth of an entire support industry that includes brokerage services, credit rating agencies, custodial services, investment banks, and credit assessors along with a revamping of the supervisory authorities that regulate these entities.

## **DEVELOPMENTS IN THE REGULATORY SYSTEMS**

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The Latin American experience with the liberalization of financial markets includes a financial collapse in Chile in the 1980s, the Mexican peso crisis in 1994, and the Argentine crisis in the 1990s; events that underlined weaknesses in the institutional supervision of banking, insurance, and securities markets. Moreover, to ensure

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**8** The recent Argentine experience is disappointing because during the economic crisis the government forced the AFPs to swap a significant portion of its government debt instruments for government trust certificates maturing in 2006. Additionally, during the crisis, the government cut pensions by 13 percent, as part of its "zero deficit" plan.

**9** In most countries in the region, financial institutions and local stock exchange systems are required to conduct a daily evaluation of pension portfolios.

the viability and success of a privatized pension fund industry it is vital that pension funds are independent from government interference, except through regulation and consumer protection laws and that a strong and stable legal and regulatory framework is in place to guarantee participants' rights and obligations.

In this respect, most countries with privatized pension systems have, to some degree, reevaluated their financial and regulatory infrastructures. Policymakers recognize the need to regulate the activities of private institutions to ensure proper execution of fiduciary responsibilities in the management of contractual savings. Accordingly, most countries in the region have created new regulatory agencies to oversee the activities of AFPs, local capital markets, and insurance companies, or have broadened the authority of the existing banking regulator to include the supervision of these entities. Although in the majority of the countries, government intervention has not been an issue, Argentina's recent intervention in its citizens' private pension accounts sets a dangerous precedent and offers a lesson for other countries to strengthen their legal frameworks to avoid similar situations.

***The supervision of AFPs.*** Foremost among the developments related to the privatization of pension systems is the birth of the AFPs, as special-purpose legal entities. These independent legal entities capture the bulk of all the mandatory and tax-advantaged pension savings and are subject to regulations that protect the individual participants from conflict of interest, by at a minimum prohibiting transactions between the AFP, its employees, and the pension fund, and banning AFPs from purchasing for their own account stocks that may be acquired by the pension fund. Following the pension reform, a special pension fund regulator was created to supervise the AFPs in Argentina, Chile, Mexico, and Perú.<sup>10</sup> In most cases, these regulators have a significant level of autonomy in terms of policy decisions and budget, and share pertinent information with the country's banking regulator either under a formal or informal agreement. In Mexico, the industry regulator, Consar, is governed by a board made up of representatives from the government, labor, and business sectors. In contrast, in Colombia and El Salvador, the banking supervisor retained the oversight of the AFPs.

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**10** In Perú, the Superintendency of AFPs was subsequently placed under the Superintendency of Banks and Insurance in 2000. In Chile, the AFPs are also regulated by the Central Bank, the Superintendency of Insurance and Securities, and the Risk Rating Commission in addition to the Superintendency of AFPs.

***The regulation of local capital markets.*** Generally, the modernization of capital markets infrastructure has promoted the growth of securities markets because securities become more attractive to investors, including AFPs. In this regard, AFPs have played a significant role in pressuring governments in the region to introduce changes in corporate laws and regulations that enhance financial disclosure, and to institute appropriate policy responses to financial innovations without hampering the entrepreneurial activities of financial market participants.

An example of enhancements to corporate governance influenced by the need to protect institutional investors is found in Chile's 1994 capital market reform, which includes insider trade limitations. Also, corporate governance enhancements are found in the amendments to Peru's capital law, which established stricter disclosure requirements for listed companies and encourages the participation of independent directors on the boards of publicly traded companies, and in the Mexican Stock Exchange's recently proposed code of best practice, which addresses corporate governance deficiencies. Chile's Capital Markets Reform II, currently pending approval from its congress, proposes the conversion to electronic securities issuance, the centralization of safekeeping of trading securities, and the creation of a single register of guarantees. All of these enhancements are aimed at increasing investors' confidence in the local capital markets.

***The regulation of the insurance sector.*** The significant role played by insurance companies in the provision of retirement annuities and disability and survivors' benefits creates a critical link between a private pension system and a strong, reliable, and competitive insurance sector, which prior to the pension reforms was practically non-existent in Latin America. The need to ensure the smooth functioning of the private pension system, therefore, also influenced the regulations affecting the insurance industry. Over the years, insurance companies in developing countries suffered from performance problems that included high administrative costs and poor marketing resulting in only a small group of the population taking advantage of their products (i.e., only the wealthy or those with longevity expectations). To achieve stronger insurance operations, insurance laws and regulations had to be reformed in Latin America to encourage the development of the insurance sector. Some countries responded by issuing more stringent licensing requirements for insurance companies and agents, enhancing reporting and disclosures, and establishing minimum capital requirements for insurance companies. Others placed restrictions on the acceptable

risk level of assets held by insurers to limit the probability of default, and most governments established guarantee funds to cover this eventuality. Based on the premise that annuities are a particular type of insurance, existing insurance companies have been authorized in most countries to offer annuities, while the supervision of insurance and annuities activities have fallen to the existing insurance supervisory authority.

In Chile, the assets of the insurance sector have grown steadily from the equivalent of 7.5 percent of GDP in 1992 to 19 percent in 2002, reflecting the significant role of insurance companies in providing annuities and retirees' strong preference for annuities because of their availability in inflation-indexed bonds.

## **WHAT'S AHEAD?**

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At the same time that private pension plans have begun to take shape in the region, significant demographic changes have transpired, especially in the aging of the population and corresponding increasing demand on the pension systems. As a result, another wave of adjustments or reforms to the original pension model is under way in several countries in the region. These are aimed at improving the sustainability of the plans by, among other things, accelerating the phasing out of remaining privileged public pension programs, encouraging greater diversification of investments and greater participation from the working population, and allowing the entry of more entities to reduce excessive and unfair costs to individual account holders.<sup>11</sup>

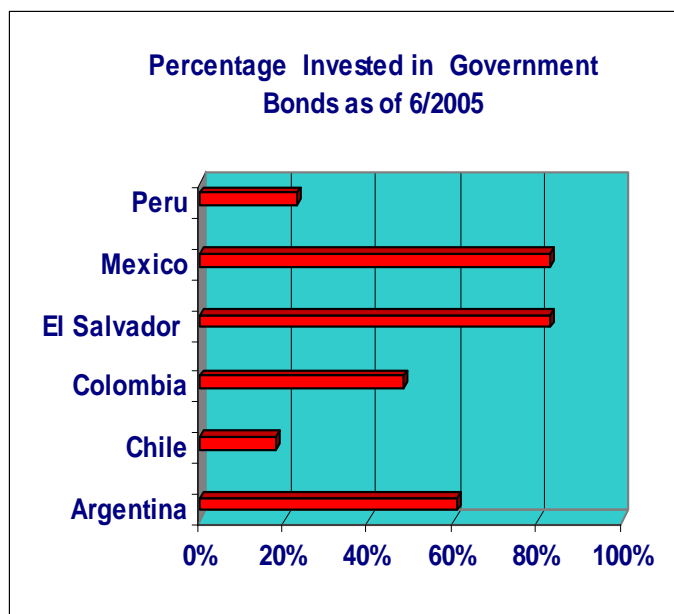
***Diversification within the investment portfolios.*** A core objective of the multi-pillar pension structure is to diversify demographic, macroeconomic, political, and financial risk. However, regulations affecting the composition of AFPs' portfolios sometimes reflect political influences and other local agendas, and AFPs' managers are often restricted to investing in government and local corporate bonds. As private pension funds have grown and consolidated at a faster pace than the local securities markets, country-specific investment restrictions have usually resulted in a concentration of government investment instruments, unduly exposing pension funds to the performance of the domestic economy and the attending sovereign risk.

One of the potential benefits of private pension systems should be the AFPs' opportunity to invest outside the domestic market to reduce political risk and preserve

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<sup>11</sup> The phasing out of certain remaining public pension programs does not imply the elimination of a government's minimal safety net to insure against poverty at old age.

the purchasing power of the savings against inflation or depreciation of the local currency. Although it is arguable that for some countries in the region with lower sovereign risk, the benefits of international diversification may be less significant, the growing trend is for the relaxation of the limits on international investments, understanding that the optimal investment mix will likely differ depending on each country's underlying structural situation.



Source: FIAP

Diversification of AFPs' portfolios has begun to occur in some countries; for example, Argentina introduced a long-term strategy in March 2005 whereby AFPs' exposure to government bonds was reduced from 65 percent of total pension assets to 61 percent by June 2005. The plan also calls for an increase in local corporate bonds, which, although commendable as a long-term strategy, might not be ideal at the moment considering the illiquid condition of the Argentine local market. In Chile, AFPs were allowed to increase their limit in foreign instruments from 25 percent to 30 percent since December 2003, and as of June 2005, Chilean AFPs' assets were invested as follows: 28 percent foreign investments, 29 percent traditional local financial instruments, 25 percent local corporate issues, and 18 percent government bonds. Investment rule changes went into effect in Mexico in January 17, 2005, allowing Afores to invest up to 15 percent of their holdings in domestic and foreign equity-linked notes that guarantee the principal. Afores are also be able to place a maximum of 20 percent of their holdings in offshore bonds or equities. However, to add prudence, the fund managers

must receive approval from Consar for each individual transaction, before investing in these new instruments, which has slowed down the diversification process. Prior to this change, Afores could invest only in government bonds and high-grade corporate bonds.

Portfolio diversification has been slower in Colombia and Perú mostly because of high returns on fixed-income securities and low trading in the local stock markets. However, Colombia's local program, Colombia Capital, proposed by the Superintendency of Securities, aims to create new investment options for small- and medium-sized companies, with the objective of deepening the local secondary market and attracting AFPs' funds. In El Salvador, where AFPs' investments in government issues reached 83 percent as of June 2005, discussions have begun in the legislative assembly to expand the AFPs' foreign investment limits. However, progress has been constrained by concerns regarding the superintendency's ability to assess the risk management processes related to these investments.

*Allowing greater competition in the pension sector.*

Another challenge faced by the private pension system is high administrative costs, which experts blame mostly on the sector's limited competition and high concentration. However, as private pension systems in Latin America shift from short-term, fixed income instruments to the capital market industry, there is a greater opportunity for investment banks, commercial banks, and insurance companies to become involved in the management of private pension funds, creating a more competitive environment.

Regulation in the region is not consistent regarding banks' and bank holding companies' ability to own AFPs, a situation that has stalled competition in countries like Chile. To prevent the potential commingling of funds and the associated potential liquidity risk, Chilean bank holding companies are forbidden by the country's Banking Law from owning AFPs or insurance companies. However, foreign banks operating in Chile, such as Santander Central Hispano and Banco Bilbao Viscaya Argentaria have a significant participation in the country's pension and insurance systems through subsidiaries of their foreign holding companies, creating an uneven playing field for local banks that wish to own AFPs and insurance companies. Legislation included in the Capital Market Reform II, currently under consideration, proposes, among other things, to allow local bank holding companies to own AFPs and insurance companies in an effort to level the playing field and increase competition. In Colombia, Perú, and El Salvador, bank holding companies are allowed to own



AFPs, partially or wholly, as in the case of the Grupo Aval in Colombia, which owns Banco de Bogotá and Porvenir AFP; Inversiones Financieras Banco Agrícola, which owns Banco Agrícola, S.A. and Crecer AFP in El Salvador; and Credicorp, which owns Banco de Crédito del Perú and opened Prima AFP in August 2005.

**Supervisory Challenges.** The emergence of financial conglomerates and financial holding companies that provide a wide range of financial and non-financial services will inevitably increase the need for consolidated supervision, a critical element in the assessment of their solvency. However, many emerging market banking regulators are still not legally empowered to supervise the top-tier holding company or access consolidated financial information of conglomerates. Some of the difficulties derive from traditional firewalls between types of financial activities and between financial and non-financial activities, while others derive from the fact that the capital adequacy requirements of each of the banking, securities, and insurance sectors have different definitions of the elements of capital and different approaches to asset and liability valuations, making consolidated supervision a major challenge.

Aware of the importance of enhanced consolidated supervision, countries such as Chile, Colombia, and El Salvador are proposing to empower their banking supervisors by broadening their authority to include bank holding companies and by creating an umbrella supervisor to regulate the activities of banks, insurance companies, and AFPs. In Colombia, the Financial Reform Law enacted in 2003, empowered the Superbancaria to request information about or perform an on-site examination of nonfinancial entities of a financial conglomerate, if prompted by supervisory concerns. In Chile, a similar arrangement allows the superintendency of banks (SBIF) to request financial and non-financial information on controlling shareholders and bank holding companies' affiliates, although on-site examinations are not allowed. New legislation proposes the merger of the country's three main financial superintendencies in El Salvador - the superintendency of the financial system, the superintendency of AFPs, and the superintendency of securities - under one umbrella supervisor, the Superintendencia del Sistema Financiero).

**Phasing out privileged public pension plans.** Although all the countries in the region with reformed pensions have maintained some version of the public pension system, in Perú, Mexico, and Colombia the government's subsidies to the public pension system have become the largest public sector liability and a drain on the fiscal accounts. To lessen the financial burden of the public pension program, the Mexican government submitted a bill to congress in 2004 to exclude civil servants from the option to retire within the public system. Instead, civil servants would receive a "recognition bond" that could be added to their private pension accounts at an AFP of their choice. Likewise, in Colombia a constitutional amendment was submitted in July 2004, proposing the elimination of all special pension regimes. The government is expected to press for congressional approval by June 2005. In Perú, the authorities are proposing amendments to the constitutional provisions that address retirement benefits with the aim of reducing or capping the retirement benefits of the public-sector workers, which represent close to 2 percent of GDP.

## **CONCLUSIONS**

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Most economies in Latin America are characterized by unstable, largely informal labor markets, with low wages, high rates of unemployment, unequal distribution of income and wealth, and high rates of poverty. Despite these conditions, the privatization of pension funds experience has been generally positive in the region, contributing to the development and the deepening of local capital markets, influencing financial innovation, and enhancing the financial and regulatory frameworks. More recently, AFPs have been instrumental in the improvement of consumer laws and the corporate governance of publicly traded companies.

Considering that privatization of the pension systems in the region has been generally a positive influence, it is unlikely that any of these countries would revert to the old PAYGO system. Nonetheless, it is evident that the current privatized models require a new wave of reforms, namely, in the area of investment concentration in government bonds, high commission costs, low and uneven participation of workers, and regulatory challenges as the sector is open to other financial institutions. As discussed, several countries are already addressing these issues at various levels depending on the political and fiscal agendas of each country.

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APPENDIX I

REFORMED PENSION SYSTEMS IN LATIN AMERICA <sup>12</sup>								
PLAN DETAILS	ARGENTINA	BRAZIL <sup>13</sup>	CHILE	COLOMBIA	ECUADOR <sup>14</sup>	EL SALVADOR	MEXICO	PERÚ
Year of Reform	1994	1977	1981	1994	2002	1998	1997	1993
Model <sup>15</sup>	Mixed Integrated	Mixed	Private	Mixed Competing	Mixed Integrated	Private	Private	Mixed Competing
AUM * (as of 6/2005)	\$20.2 billion	N/A	\$63.3 billion	\$13.0 billion	N/A	\$2.6 billion	\$49.4 billion	\$8.5 billion
Investment Funds	One	Multiple	Multiple	Multiple	Multiple	N/A	Multiple	One
Contribution to IRA	5%	N/A	10%	10%	N/A	10%	6.5%	8%
Pay-out Options	Annuity or Scheduled Withdrawal	N/A	Annuity or Scheduled Withdrawal	Annuity or Scheduled Withdrawal	N/A	Annuity or Scheduled Withdrawal	Annuity or Scheduled Withdrawal	Annuity or Scheduled Withdrawal
Guaranteed Minimum Pension?	Yes	Yes	Yes	Yes	Yes	Yes	Yes	No
Special Regulator?	Yes	No	Yes	Yes	No	Yes	Yes	Yes

Source: FIAP (www.fiap.cl)

<sup>12</sup> Bolivia has also undergone pension reform; however, a discussion of its successes and failures is not included in this paper because there are no foreign banking organizations from Bolivia operating in the U.S.

<sup>13</sup> Brazil's pension reform does not qualify as "structural" among pension specialists because it did not introduce a system of mandatory private savings accounts. Private pension savings accounts are voluntary and serve as a supplement to the public system. Accordingly, the publicly-managed first pillar is large, while the voluntary privately-managed third pillar is relatively small.

<sup>14</sup> Although Ecuador passed a new Social Security Law in 2002, new regulations to govern the private pension sector have not been issued. Therefore, the system remains almost entirely in public hands, while some workers have supplemental retirement accounts with not-yet regulated AFPs. Lack of political support is to blame for the slow progress in the privatization of the social security system.

<sup>15</sup> In a mixed integrated system both public and private systems complement each other, while in a mixed competing system the government provides a first-tier public benefit and individuals have a choice of public or private benefit for the second tier.