

BBVA

Pension reform and retirement outcomes in Latin American Countries

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Global Pensions and Insurance

BBVA

**8th Annual IIEF Pension
Policy Conference**

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Hightlighted credentials

The context

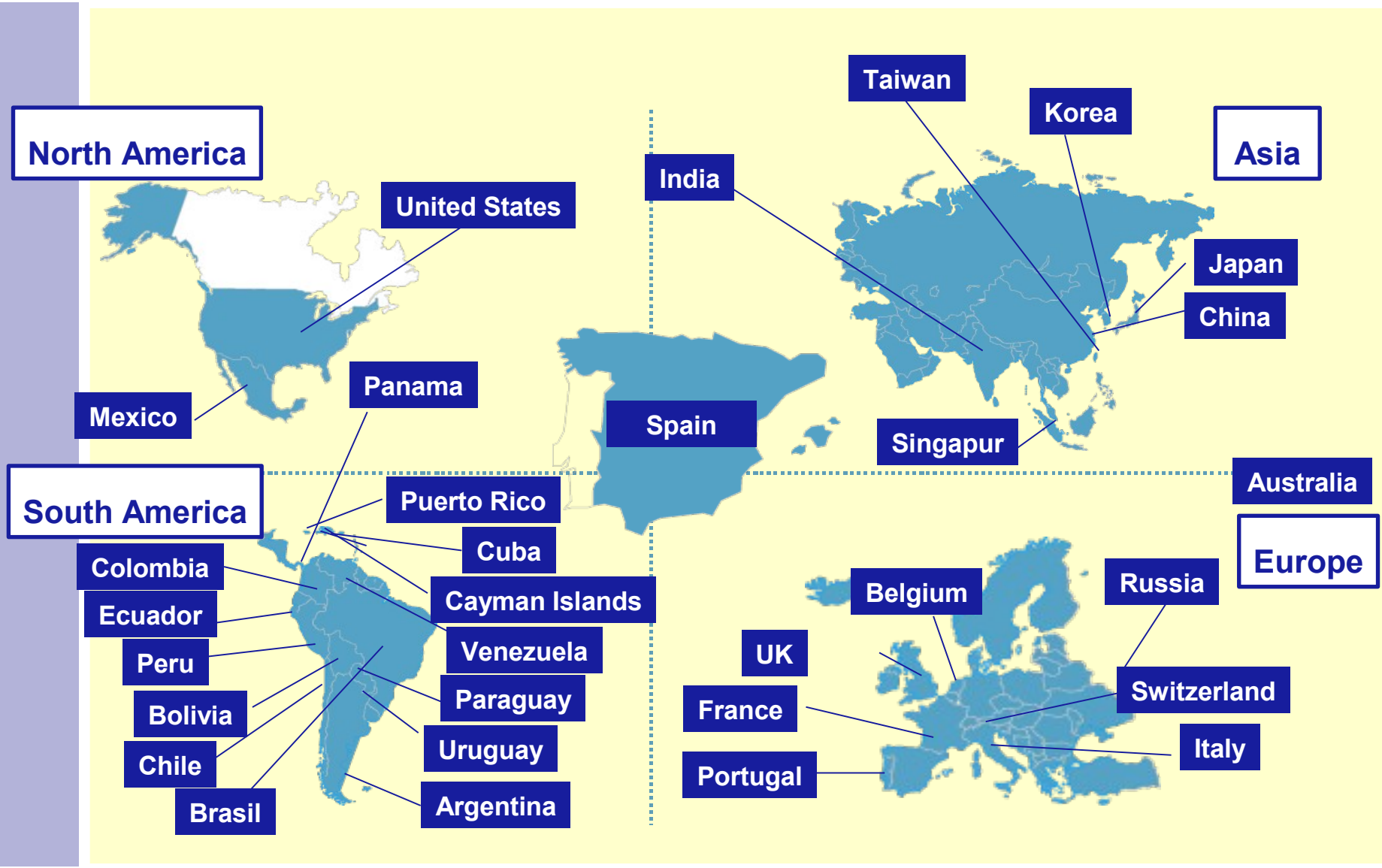
Reforms in Latin America

The case of Chile

Regulatory and governance issues

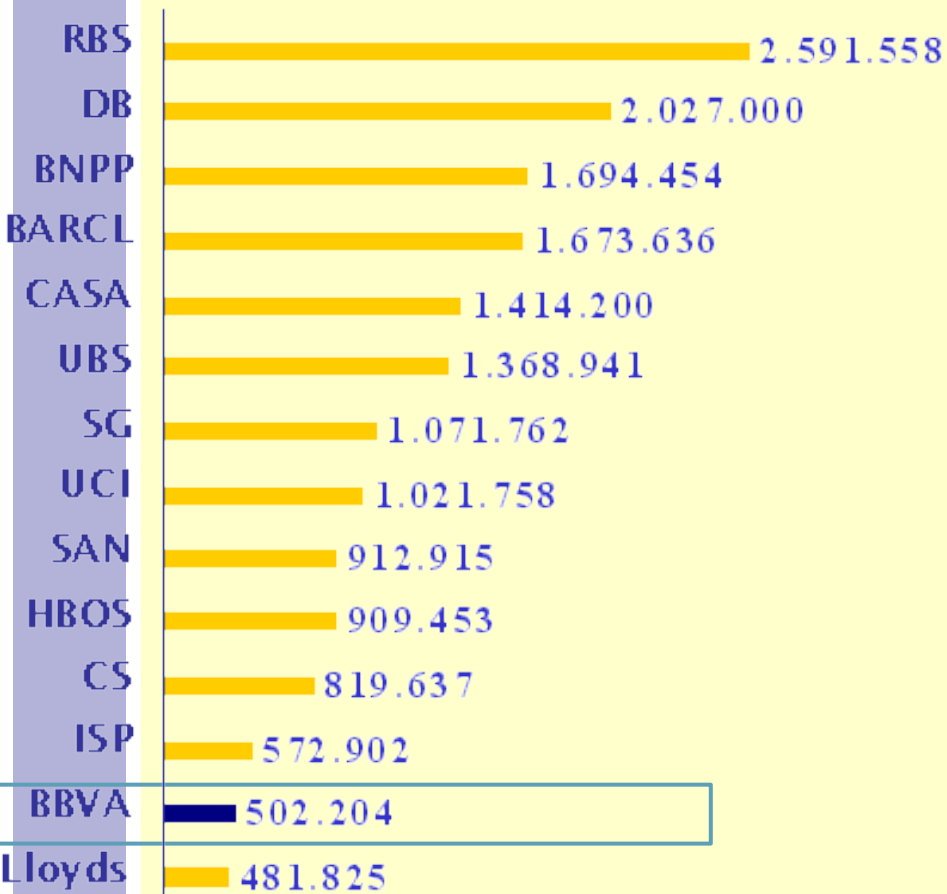
Conclusions

BBVA is one of the largest and most internationally driven financial institutions in the world

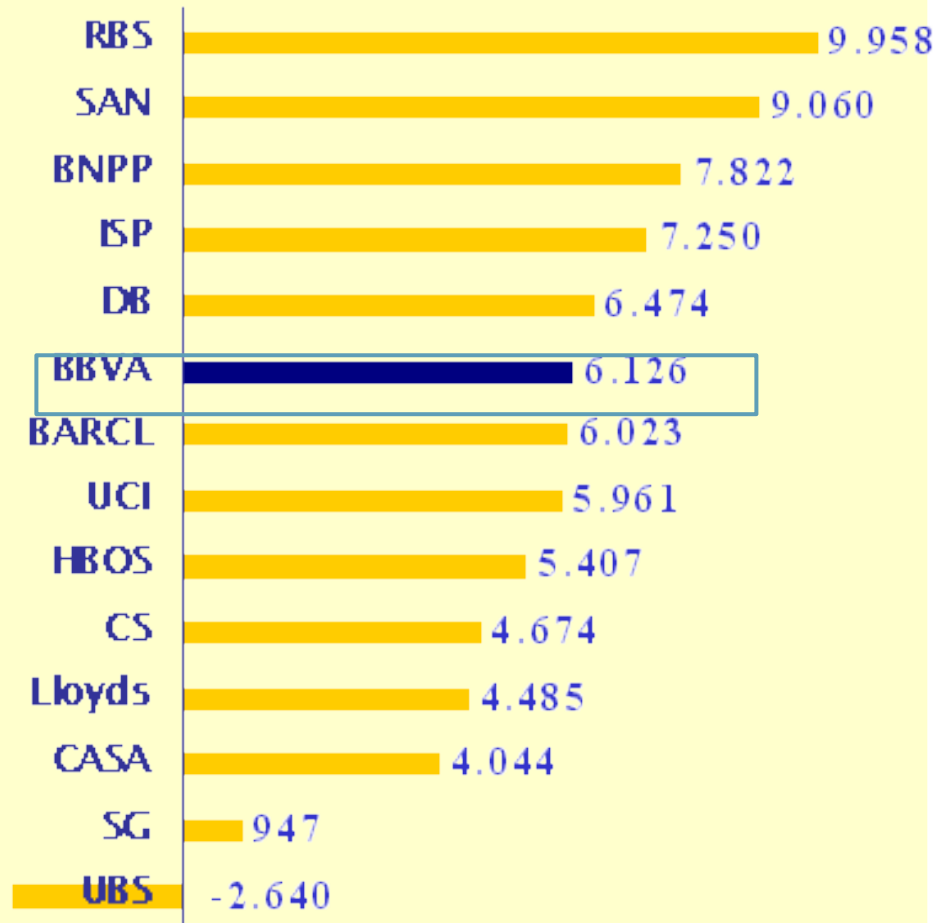


Clearly ranked on top lead tables of european peers

Assets 12M 07
(€ million)



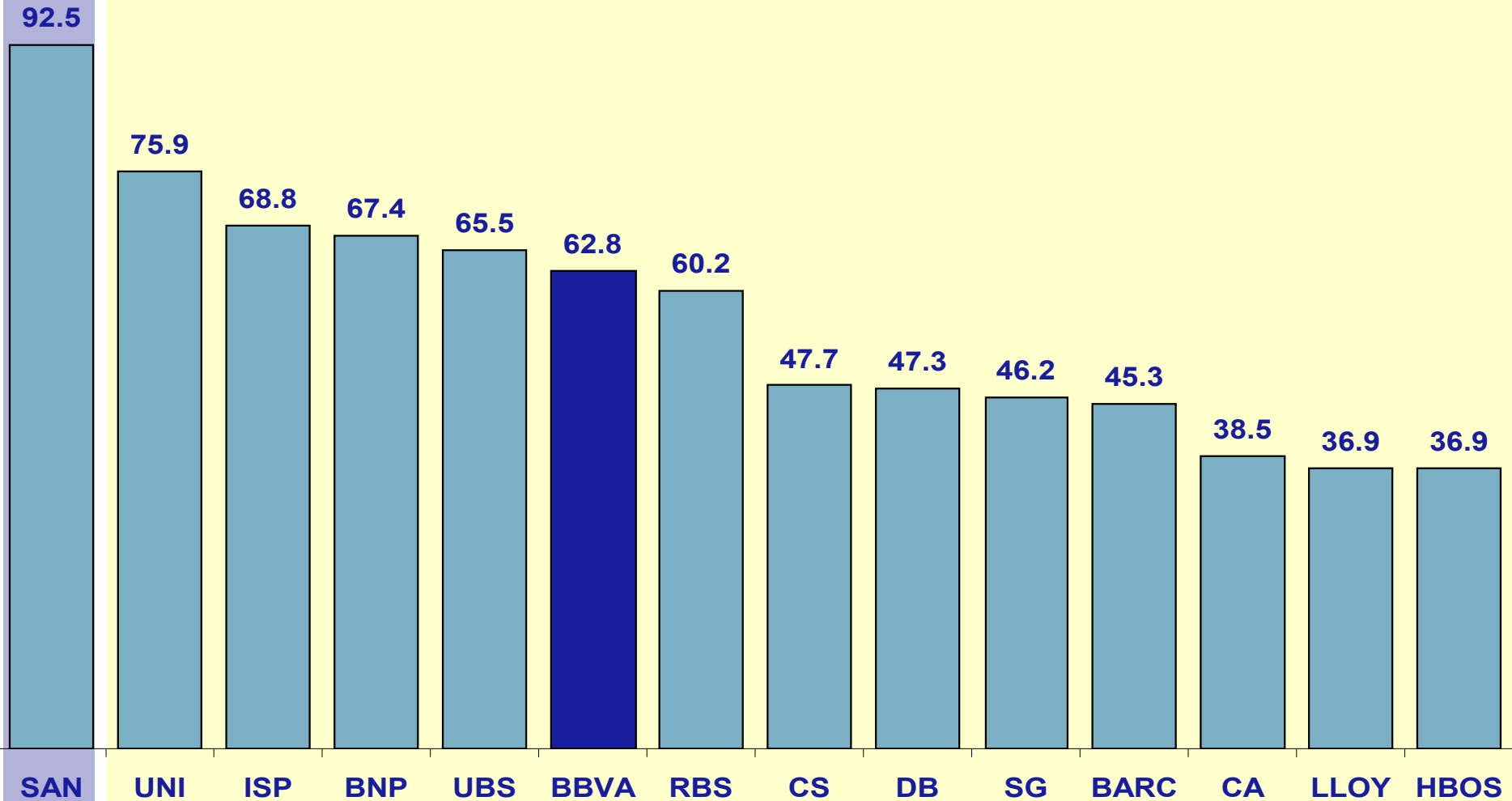
Attributable profit 12M 07
(€ million)



And also in market capitalisation... .

Market Capitalisation

(€ Trillions, December 07)



BBVA, 6th in peer group

Largest banking and retirement franchise in Latam

Loans

Deposits

Pens. Funds

Country	Ranking	Market share	Ranking	Market share	Ranking	Market share
Argentina	2nd	8.3%	2nd	9.6%	3rd	18.4%
Colombia	4th	11.1%	4th	11.9%	3rd	17.0%
Chile	4th	8.9%	4th	8.1%	1st	30.9%
Ecuador	-	-	-	-	1st	78.3%
Paraguay	1st	19.9%	1st	16.0%	-	-
Peru	2nd	25.4%	2nd	22.9%	3rd	22.7%
Uruguay	5th	9.5%	5th	8.2%	-	-
Venezuela	4th	12.5%	4th	9.6%	-	-

Source: Central Banks and Superintendents

In pensions administration BBVA is the top administrator both in Spain.....

Industry peers	AUM (MN Euros)	Market share	RANKING
Group BBVA	15.502,2	17,91	1°
LA CAIXA	11.065,4	12,78	2°
SANTANDER	9.801,3	11,32	3°
FONDITEL	5.389,3	6,23	4°
IBERCAJA	4.131,4	4,77	5°

Data as of Dec 2007

and in Latin America . . .

Data as of December 2007

	Assets (MN USD)	Members (million)	Contributor s (millions)	Contributions (MN USD)	Ranking		Presence in LATAM
					Eq.	Mem.	
BBVA	63,110	12.4	5,3	3,096	1	1	AR,BO,CL,C O,EC, MX,PE
CITI	46,594	10,0	4,4	2,513	3	3	CL, CO, MX, PA,PE, UR
ING	50,620	11,4	4,4	1,654	2	2	CL, PE, MX, CO, UR, AR
METLIFE	7,006	1,6	0.8	381.7	4	4	AR, MEX

BBVA manages 23.5% out of 262.540 million usd cumulative Pension Funds in the R as of DEC 07 and deals with 17,7% of the 70.42 million total affiliates

New markets opportunities under the radar

Business vision

Specific monitoring of pension new regulations in target marketplaces with common synergies with our long track record experience in Latam and to expand business reach of the franchise

Multipronged approach

- ✓ Market research surveys
- ✓ Collaboration in Multilateral agencies' dedicated research reports
- ✓ Participation in conferences and field trip to gather intelligence

China

Cooperation agreement with strategic partner, Citic Bank, to develop high growth Enterprise Annuities' market

India

Field trips in different business segments with potential cross collaboration in pensions

EEUU

Future collaboration with local franchise, Compass bank in future reform of private sector pensions

Other markets

- Honk Kong
- Brazil
- Eastern Europe

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Social-security systems reforms are being discussed, or are underway, in several countries around the world.

Most of the countries are evolving towards defined contribution schemes.

The reasons for promoting the reforms vary from one country to another, but mainly include the need to:

- Improve the benefits of the system.
- Population ageing
- Labor market structure
- Inefficiencies and administrative problems
- Fiscal budgets

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Parametricals reforms: Rationalization of PAYG systems, by the standarization and adjust of the elegibility conditions and benefits, also improving information systems and administrative procedures.

Structural reforms: Changes in the structural foundation of the system. This reform gives places to three modalities. ~~Evolution towards individual accounts:~~

Replacement model: Complete switch from a defined benefit system managed by the State, to fully funded individual contribution defined schemes. PAYG system is closed for new hires.

Mixed model: Public and private structures coexist and they are integrated. Complementarity sets forh because the public system provides a basic or minimum pension and the private pillar gives a supplementary pension.

Parallel model: Public and private pillars coexist but they are not integrated. The public pillar is administrated by the Goverment, and the privatized ones by private organizations; workers choose one of them.

Some parameters and characteristics after the reform

Country \ Feature	Model	Contribution rate (wage %)	Retirement age
Chile (1981)	Sustitutive	10%	Men: 65 Women: 60
Mexico	Sustitutive	Private: 6.5% Public: 11.3%	Private: 65 (men and women) Public: Men 60 Women 58
Colombia	Parallel	Private: 11% Public: 12.5%	Private: When pension is => 110% of minimum wage Public: Men 60 Women 55
Peru	Parallel	Private: 10% Public: 13%	65 (men and women)
Argentina	Mixed	21.7%	Men: 65 Women: 60

Contributions:

Each worker keeps an individual savings account with his contributions

Workers ownership

Mostly mandatory for dependent workers

Financial regime:

Individual Capitalization

Accountability:

Legal and financial accounting separation between

Pension Funds and A FP Company

Institutions:

Management by specialized institutions (A FP)

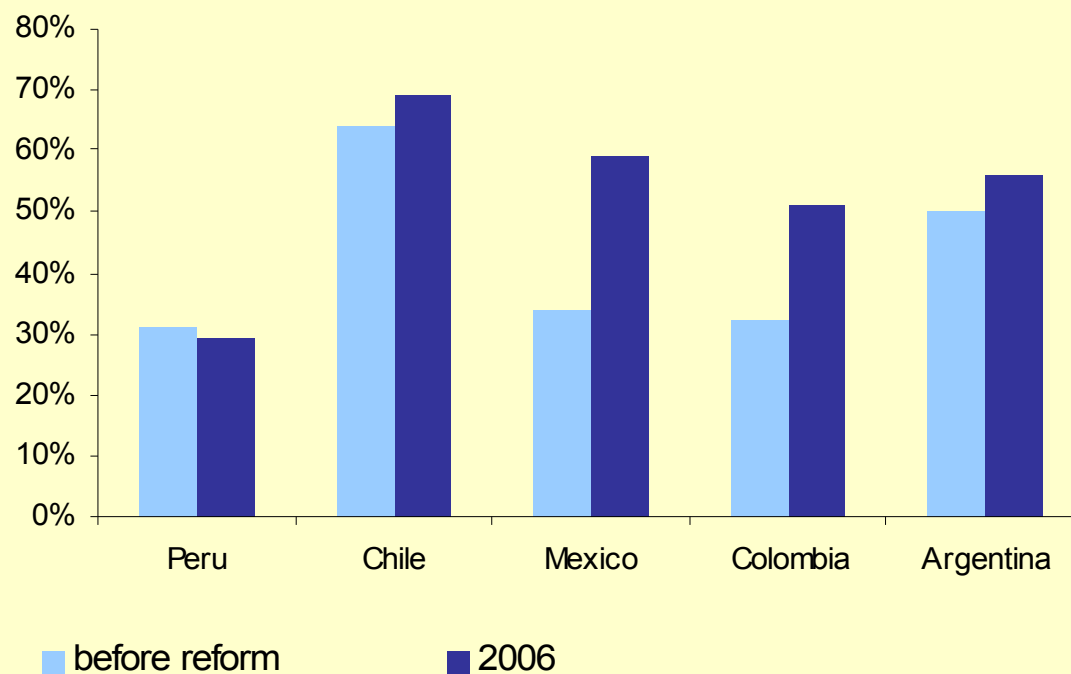
It strives for efficiency and competition

Freedom for workers:

To choose and switch A FP

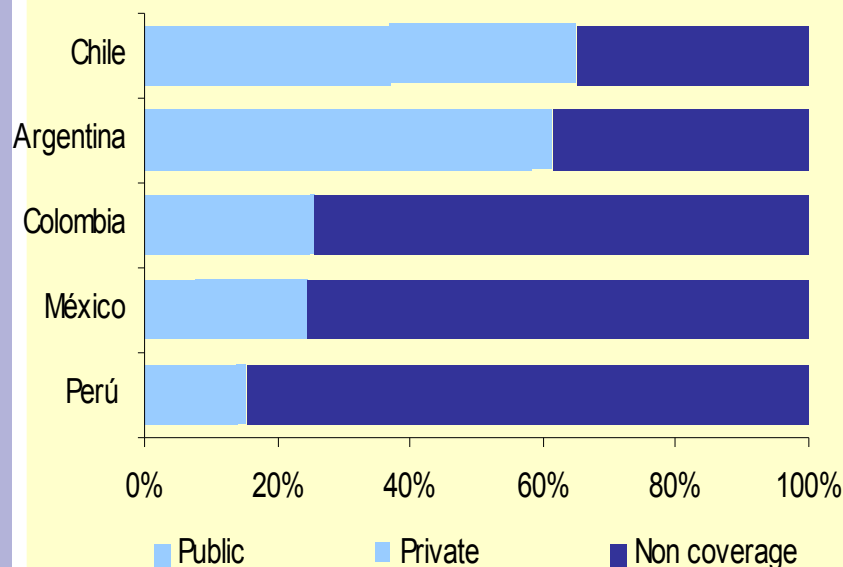
The Government
maintains
responsibility for the
system by assuming its
subsidiary and
regulatory role

Coverage before and after reforms



A clear improvement of coverage ratios

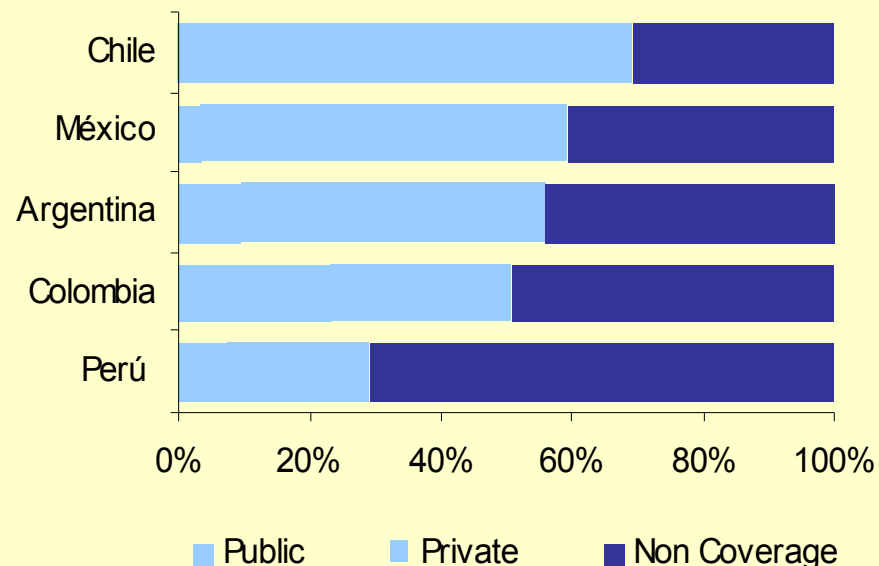
**Coverage 2006
Pensioners/Pob>64**



Structural economic factors like poverty, working conditions, high tax burdens and informality prevent to achieve a better performance.

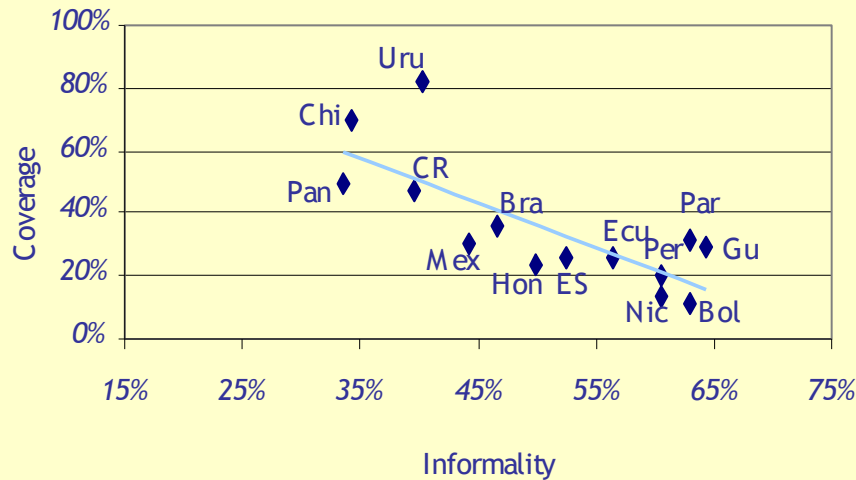
However, coverage ratio continue to be a big challenge in some Latin American countries.

**Coverage 2006
afil/Pob 14-64**



The link between labour market informality and Coverage

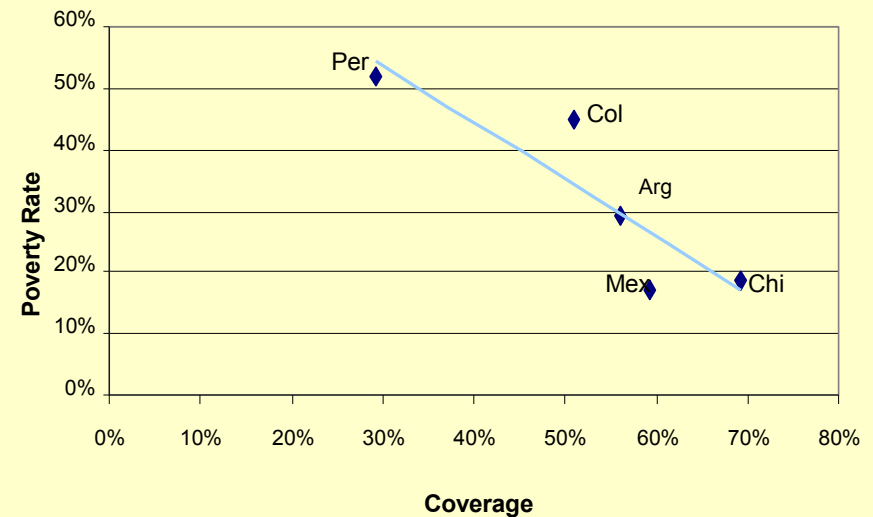
Informality and Coverage



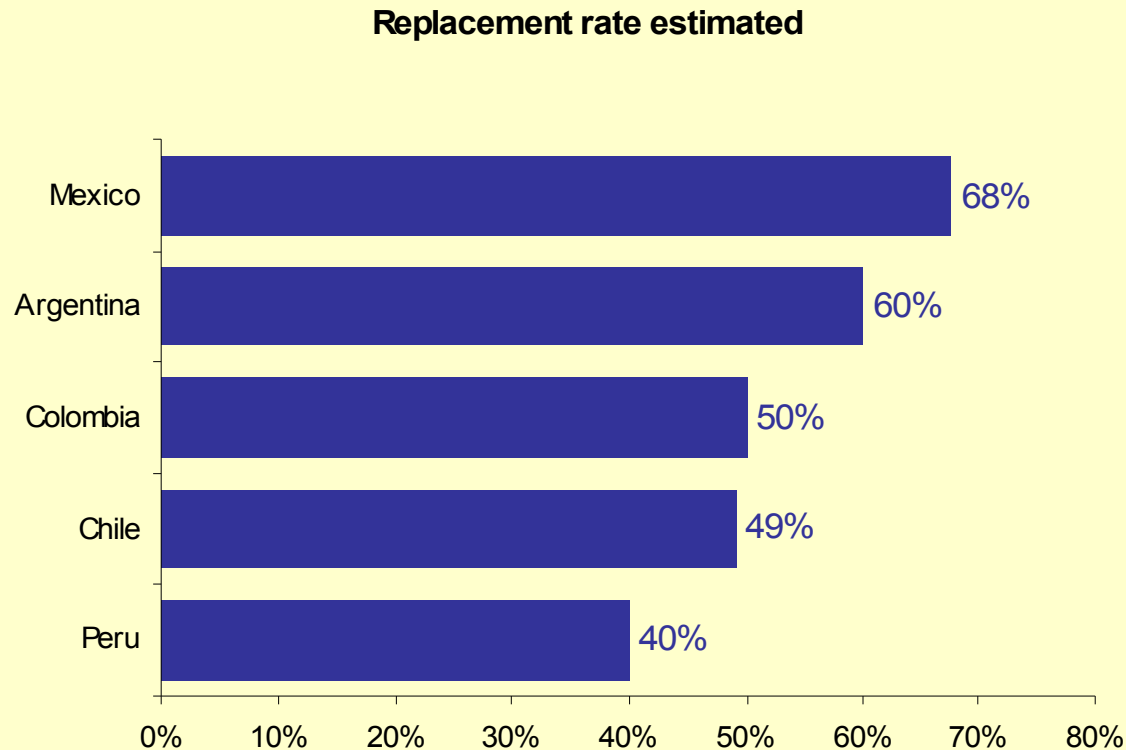
In less developed countries coverage ratios are strongly related with labour market characteristics.

Poverty is a clear constraint to private saving schemes.
Government focused support is highly recommended.

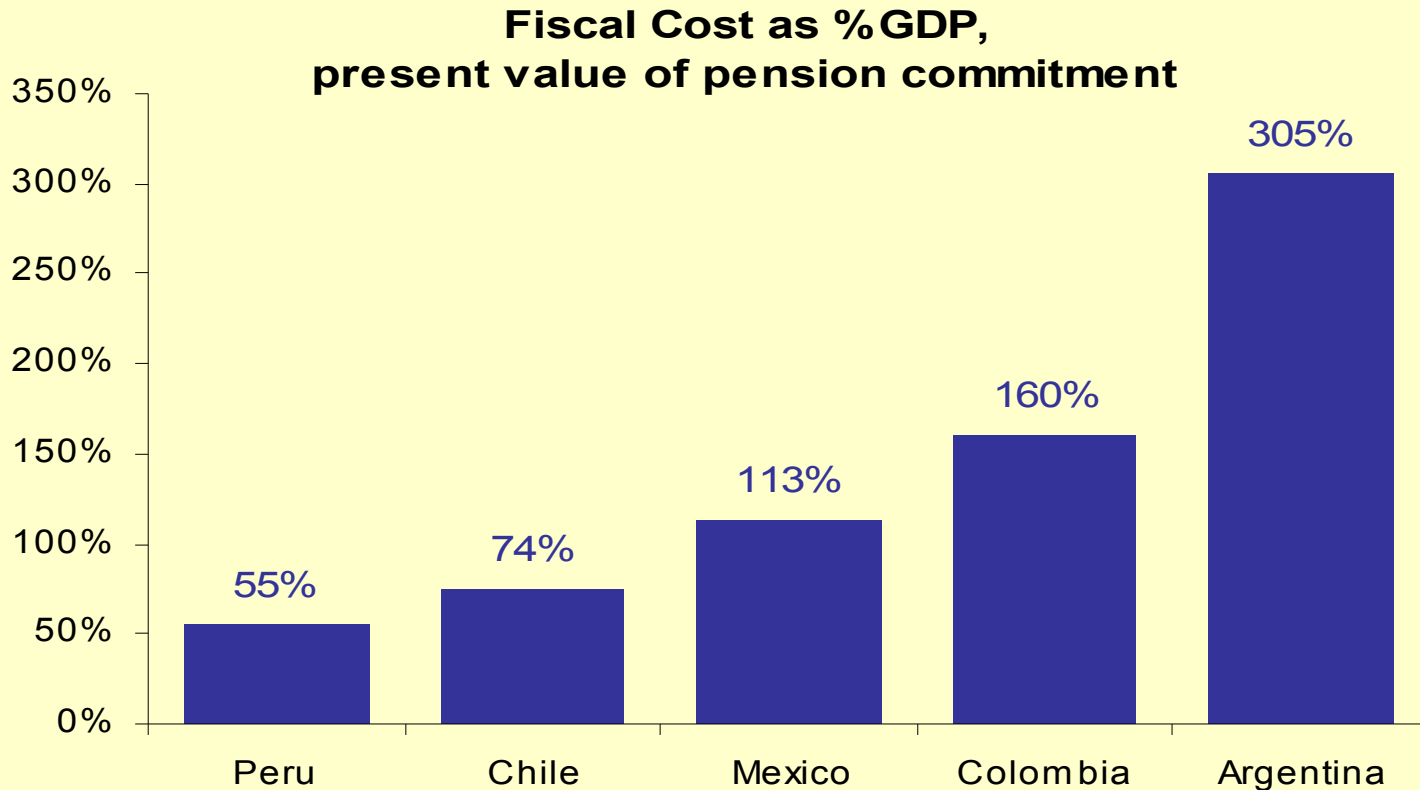
Poverty and coverage, 2005



Replacement ratios varies according to different factors

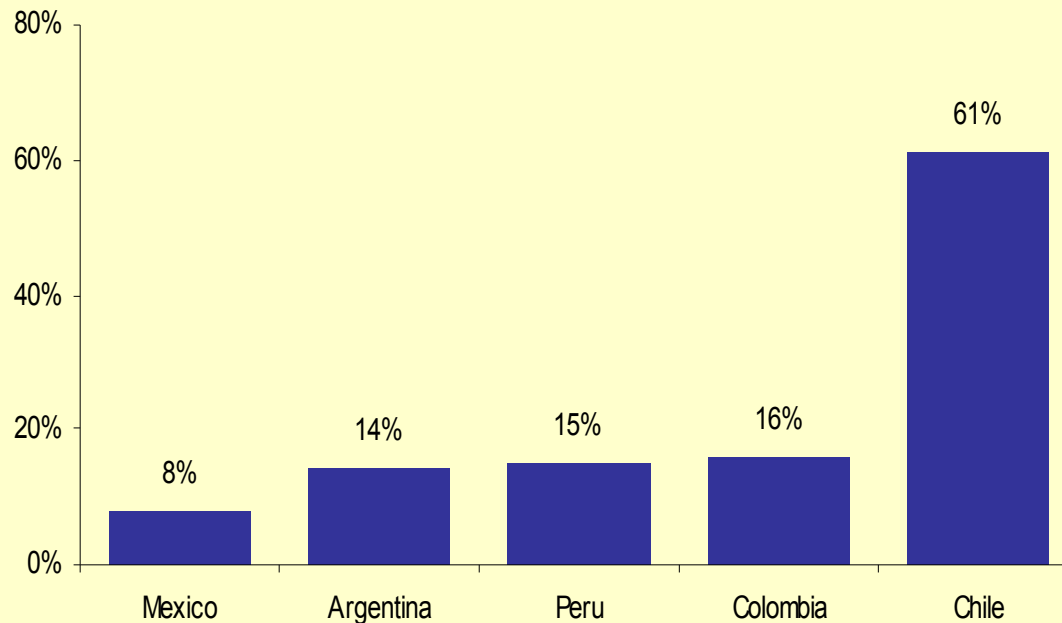


- Parameters of the system
- Frequency of contribution
- Income level
- Government generosity (with consequences on fiscal deficits)



Economic policy decisions preempt the degree of success of fiscal conditions after reforms.

Funds as % over GDP - 2006



Years since
the reform

9

12

13

13

25

The amount of funds managed depends on financial development, country wealth and years of implementations of reforms.

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By 1980 the Chilean system was running a deficit equal to 2.7% of GDP and the discounted present value of the system's contingent liabilities exceeded country's GDP.

Chile's first pension reform replaced a "pay-as-you-go" system with a private system based on individual accounts. The old system was closed for new affiliations.

Workers' contributions are managed and invested by a government-approved private investment firm (called AFP).

Participation in the new system was voluntary for workers who were covered by the old system, but it is mandatory for new workers. They must contribute 10% of their wages to their private investment funds, and another percentage of their wage to cover disability and survivor insurance. Self-employed workers don't have to participate, but they may join upon request.

Workers who belonged to the old system and decide to join the new pension system received a compensation, called **Recognition Bond**, incorporated into worker's pension account when they retire.

The recognition bond tries to capture the value of accrued pension payments corresponding to the old PAYG scheme, and is based on a formula that consider life expectancy, the numbers of years they of contribution to the old system, among others.

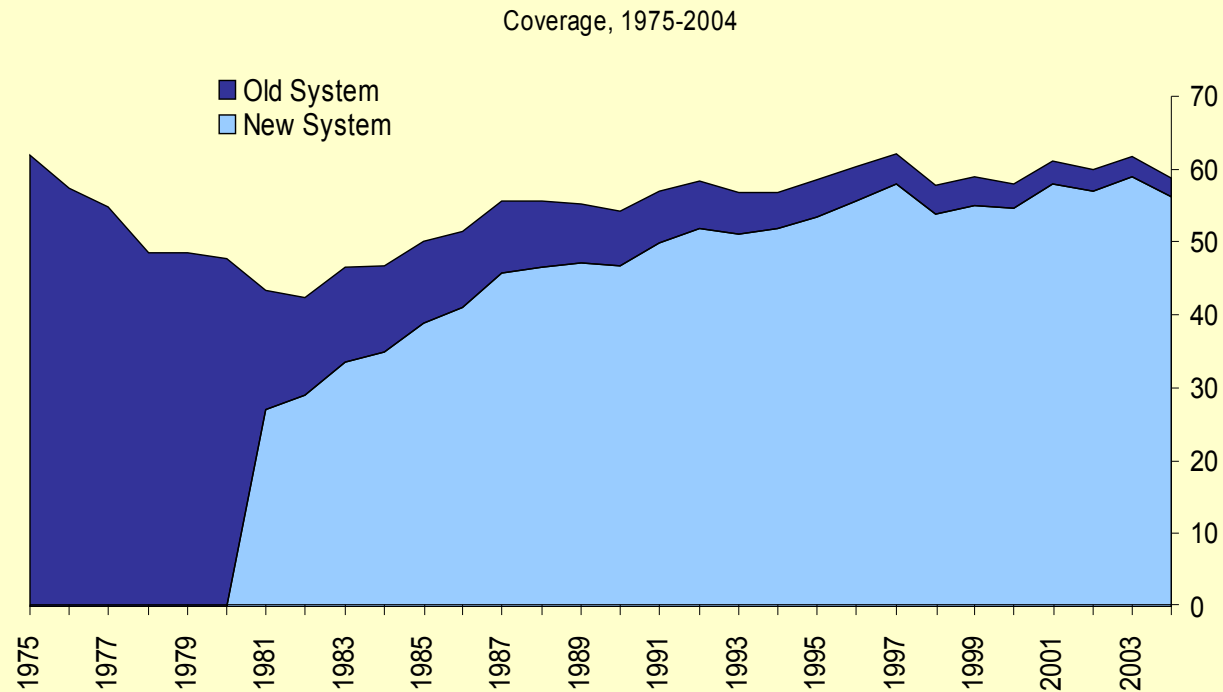
When men reach 65 years old, and women 60, they have two withdrawal options:

- Purchase a life annuity.
- Withdraw funds on a regular basis according to a **predetermined plan**. Lump sum option is not allowed.

First Pillar:

Workers who have contributed for at least 20 years and whose accumulated funds can't reach a minimum threshold pension, receive a transfer from the government that raises their pension to that minimum.

Workers who don't qualify for the minimum pension and don't have enough income, are eligible for an assistance pension, which is much lower.



The system has extended coverage to those who regularly contributed and belong to the formal labour market. However workers from informal sectors and vulnerable groups such as women require joint effort to improve access to the system.

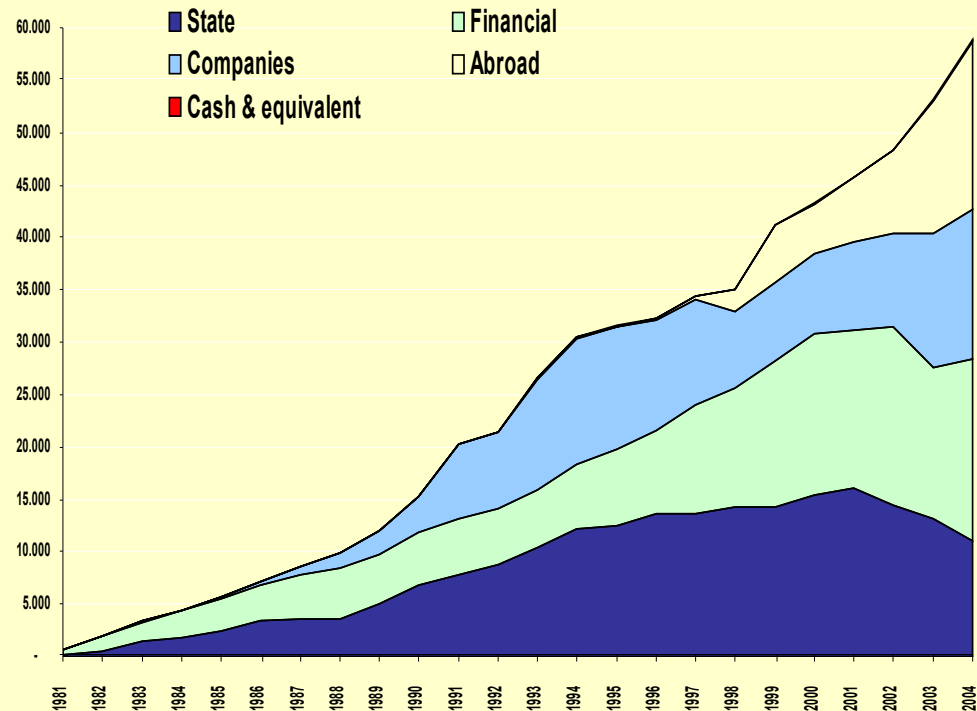
Another source of lack of coverage is independent workers, who didn't have the obligation to contribute. In 2003 while 76.3% of dependent workers contribute to the system, only 6.5% of independent workers do so.

AFPs only invest in financial instruments expressly authorized by the regulation.

Initially they were mainly restricted to specific financial instruments: government securities, bank deposits, investment-grade corporated bonds, and mortgage bonds.

Gradually new types of investments were accepted, including equity, foreign securities, and real estate.

Evolution of the investment of pensions funds by sector and corporate financial instrument, December 2004



Source: Superintendencia de AFP, Chilean Government

The first architecture did not consider particular features of the affiliates that affect risk and return. In 2002 the legislation introduced the multifund scheme, which allows to invest in different kind of funds designed according to affiliate's preferences (return and risk preference) although with some restrictions (age and years before retirement).

Fund type A has a major proportion of funds invest in equity, that proportion is going down progressively on funds type B, C and D. Fund type E can only invest in debt instruments.

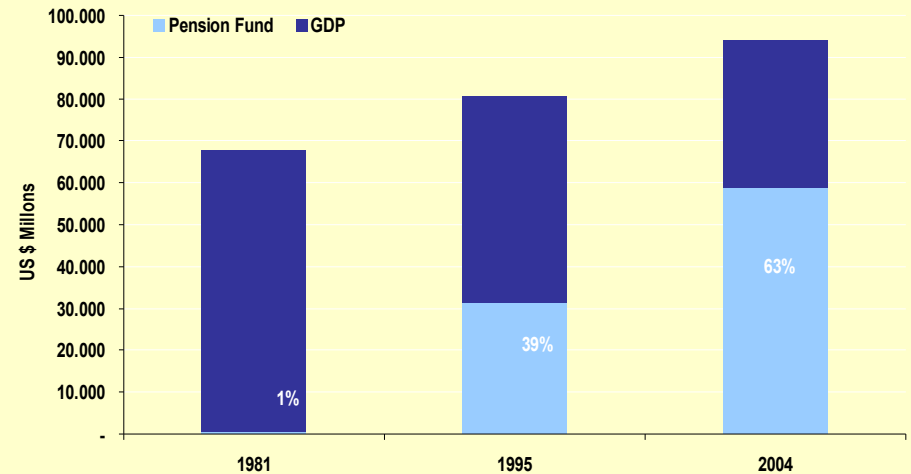
The system is tightly regulated, with more than 60 specific limits which must be respected at all times.

There has been a **dramatic increase in the amount of the fund assets** in a relatively short period of time.

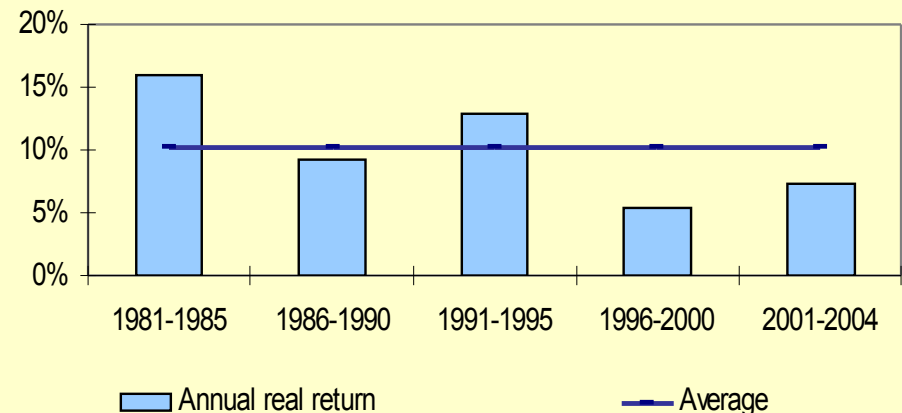
The growth of pension funds has outsized the speed of development of the local financial system.

Meaningful annual real return.

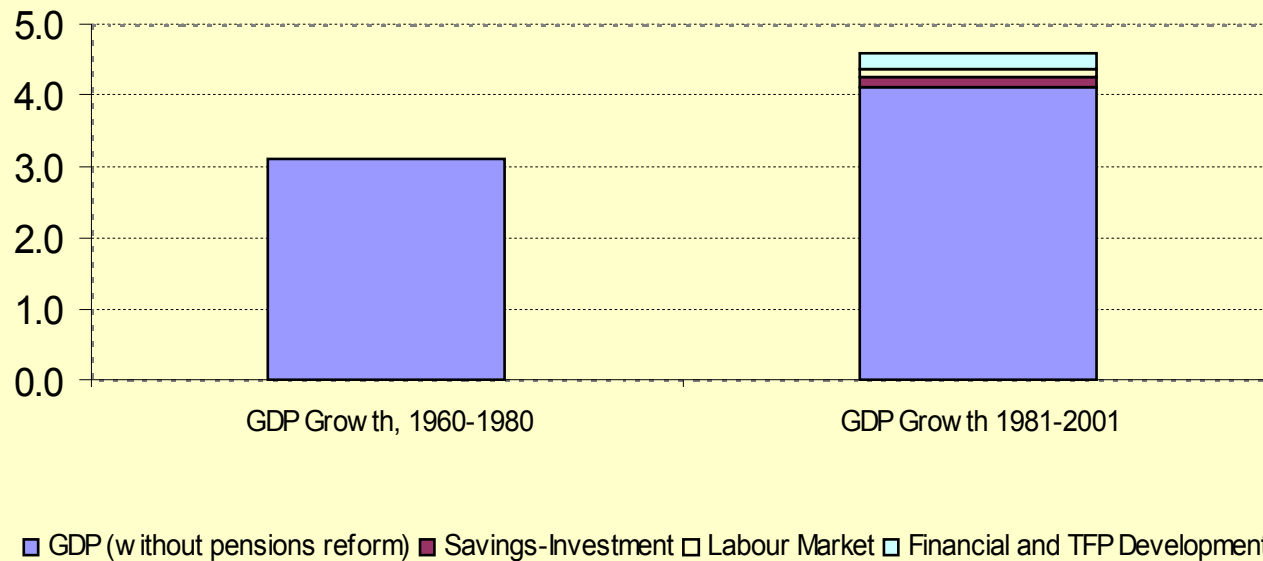
Accumulated balances



Annual real return of pensions fund type "C"



Estimated impact of reform on GDP's growth



Source: Corbo, V. Schmidt-Hebbel, K (2003)

There are positive indirect effects on the economy, when a pool of long-term savings is created and effectively channeled into projects that increase economic growth, or when pension funds contribute to greater liquidity and depth in domestic capital markets.

Even when the first reform were successful in many issues, it was necessary to promote new changes in order to:

- Improve coverage, especially to reach out to self-employed (mandatory and enforced)
- Improve the density of contributions to the system, especially from young workers (a grant for young workers at the first stage of labor cycle)
- Improve women's situation, who had lower replacement rates (a bonus to mothers for every live birth or adopted child)
- Expand investment opportunities for funds in order to preserve the high rates of profitability (reduction and elimination of quantitative limits).
- Improve safeguards for lower income workers (improving the solidarity scheme).
- Further development of voluntary contributions (employers supplement and tax incentives).

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Private pension system scheme



INDIVIDUAL AFFILIATION

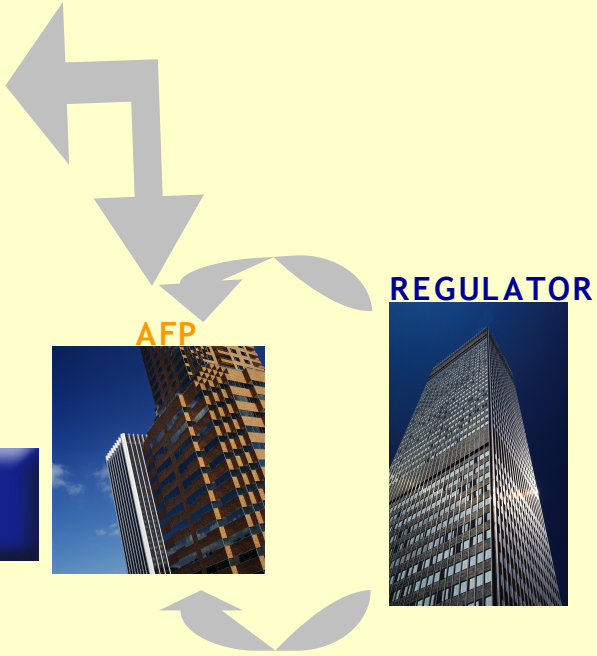
CONTRIBUTION



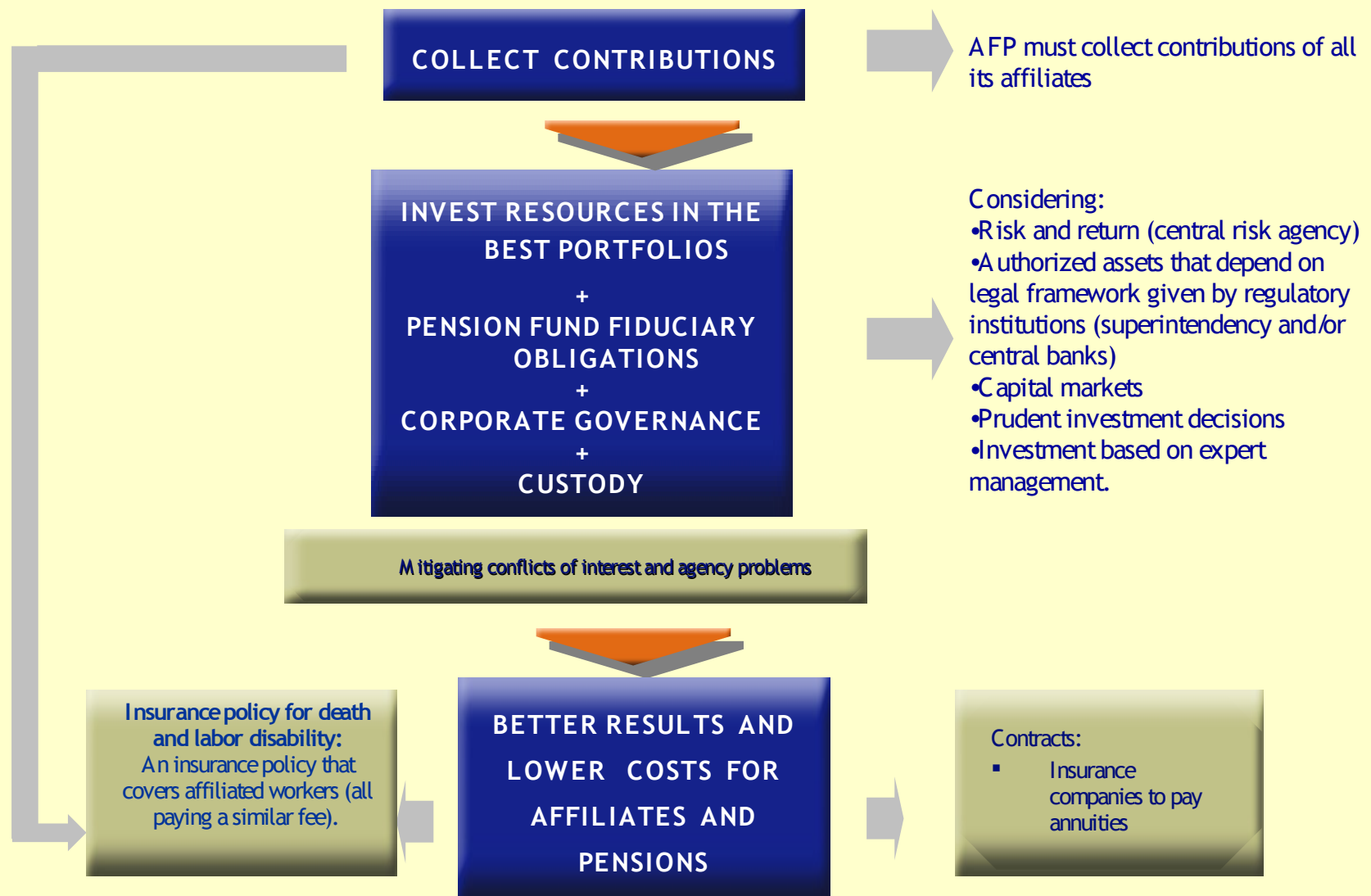
PORTFOLIO MANAGEMENT (AFP)



PENSION



A FPs are not only portfolio managers. They also are collectors of contributions and have responsibilities with affiliates



- Required minimum capital (US\$200,000).
- For each type of fund there is a profitability CAP. To ensure there will be a “Profitability Fluctuation Reserve”.
- For each type of funds in the law exists specifics maximum and minimum limits for investment in each of the instruments in which it is allowed to invest.

The investments made with resources from the Pension Fund will have the sole purpose of obtaining adequate security and profitability.

The resources of pension funds may not be invested in shares of Pension Fund Administrators and related companies.

Specific restrictions for investment in equities, debt instruments or those guaranteed by companies related to the Administrator.

The resources of the fund may not be invested in securities issued or guaranteed by the respective Fund Manager.

Incompatibility between being director of a Pension Fund Administrator and to participate (as a worker, director and other considerations) in other financial institution or third party.

The Administrator is forced to compensate the Fund under management for the direct damage that any of its directors, employees or persons who render services, caused as a result of the performance or failure to perform as required by law.

It prohibits the use or disclosure of privileged information.

The Superintendency of Pension Fund Administrators (the national regulator) has the function of super-monitor and control the system. In turn, it is under the control of the General Comptroller of the Republic.

The Administrators must inform to the Superintendent about the transactions instruments they carry out.

Securities representing at least 90% of the value of each of the pension funds, must be maintained at all times in the custody of the Central Bank of Chile.

Simple essential bylaws

Creation of the **Technical Board of Investment (TBI)** which advise ministers on the subject of investment of pension funds and recommend, for example, changes to the spending limits.

The **National Regulator** can't introduce changes to the **Investment Regime** that were rejected by the TBI and shall indicate why it doesn't consider the recommendations of TBI, if that were the case.

More **restriction and monitoring to corporate activities**:
e.g. banks and fund managers.

It **reinforces the standards that seek to prevent conflicts of interest**:

The prohibition for the banks and AFPs to integrate in common activities used to the affiliation process.

The prohibition of investing in securities issued or guaranteed by the AFP respective or persons related to such AFP.

The AFP board should formally establish their investment policies and report to the regulator and the public of these guidelines, their failure to do so will be disclosed and punished.

It is mandatory that AFPs constitute investments committees on their boards.

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1. Meaningful Latin American pensions reform have shown results by providing macroeconomic and financial long term stability which is a key factor for a succesful reform in the long term.
3. The system has increased the level of coverage and pensions, however some countries face clear challenges as a consequence of structural difficulties: low income level, poverty and informal sector limiting savings ability.
5. That situation raises questions about the Goverment role (key factor: fiscal stability) and how to develop a sustainable complementarity between public and private interests. The Chilean experience could be a good example of that evolution (First and Second Reform).
7. The regulation on the Latin American pension sheme has proved to be succesful in generating high returns, risk control, transparency and governance during almost thirty years of performance.

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