COLOMBIAN MANDATORY PRIVATE PENSION SYSTEM
SUPERVISION AND REGULATION CHALLENGES
PRINCIPAL REFORMS TO DO[1]

INTRODUCTION

- First of all, I want to thank the Organization for Economic Co-operation and Development (OECD) for participating in this meeting about Private Pensions and allowing me to share with their members some topics about my country's system.

- Also, I want to congratulate OECD´s initiative in the creation of the International Organization of Pension Supervisors (IOPS), to which AIOS (International Network of Pensions Regulators and Supervisors, Colombia a member) has already given its approval to become part of.

- Until 1993, our pension system had a "pay as you go" scheme. For long time, there where pensions which had minimum quotations or none at all. Naturally, it was in the public sector where most of the generosity to workers occurred, who created various special pension systems through laws or collective bargaining agreements.

- Since 1993 (with Law 100), our country established the mandatory private pension system also called private individual saving or capitalization system, but with quotations to an assistance regime[2] and with contributions for solidarity[3].

- Colombia's legislator chose to maintain a dual system, that is that today people can choose between the pay as you go system and the mandatory

[1] Conference by Ligia Helena Borrero Restrepo, Superintendent Delegate for Social Security and Other Financial Services. Paris, 14th December, 2004.
[2] A percentage is quoted as contribution to Pension Solidarity Fund that has as main objective to subsidize contributions to General Pension System of workers who lack enough means to quote over one minimum salary (community mothers, peasants, indigent ancients) and grant a subsistence pension to people over 55 years old (ISS) or 58 years (private pension funds) who lack sufficient capital to receive the minimum pension.
[3] Quotation is also used as contribution for the funding of minimum pensions, at least equivalent to 1 minimum salary (USD 138), to those people who have quoted for 1.150 weeks and have reached 57 years women, 62 men. Since 2009, the number of weeks to quote increases in 25 per year until reaching 1.325 in the 2015.

private pension system, with the possibility of moving from one to other every 5 years but, with the purpose of preventing the effects of adverse selection, there is the impossibility for those who are missing less than 10 years to meet the pension age for the pay as you go system. (55 years for women and 60 years for men). Between private funds, affiliates can move every 6 months.

- The political and legislative decision adopted by our country implied a benefit reduction and raise of pension ages but creating a transition regime and respecting acquired benefits. It also implied to turn explicit a huge fiscal liability but necessary, given the existence of common phenomena in all latitudes: States and very generous companies, aging of population, extension of life expectations, contributions and insufficient quotations and a major intergenerational problem, given that actual and future generations will have to assume, through taxes, less social investment by States and bigger personal savings, commitments acquired by their antecessors.

- Today, there are 11.338.500 affiliates to the pension social security system, 50.5%, 5.734.600 people are in the pay as you go system and 49.5%, 5.603.900 people are in the mandatory private pension system.

- All the system and its administrators, both public and private, are supervised by the Superintendency of Banks of Colombia (SBC) through the division that is under my charge.

- With respect to the resources administrated by the general pension system, it can be seen a continuous growth in those under the mandatory private pension system and a constant reduction for the past years in those of the pay as you go system, for the already mentioned reasons.

- The quotation rate, applied over worker's monthly income, has had an increasing evolution. The quotation percentage in the pay as you go system and in the mandatory private pension system is the same; the difference lies in the way of distributing the mentioned quotation. In the pay as you go system, part of the quotation is destined to increase for old age pension reserves and the rest to cover the administration commission and disability or survival pensions. In the other hand, in the mandatory private pension system, part of the quotation is destined to the individual's private account, other part to the administration commission, other to the acquisition of insurances for invalidity and survival pensions, and the rest is destined to a fund that guarantees minimum pension for affiliates to the mentioned regime. The employer pays 75% of the quotation and 25% the employee. The affiliates of both regimes must quote to a solidarity fund, proportional to their income.

- The pay as you go system is administrated by public entities, through a great fund called the Instituto de Seguros Sociales (ISS) which is the only fund that continues to have legal permission to receive affiliates. With the reform, the liquidation of more than 1.000 public and private funds was ordered, given the fact that it was determined that they were not solvent or viable. Today, other 5 funds exist that were determined as solvent and viable but exist only to administrate pensions of affiliates until April 1, 1994.[4]

CHARACTERISTICS OF MANDATORY PRIVATE PENSION SYSTEM IN COLOMBIA

- Given the above precisions, now I will refer specifically to the mandatory private pension system in Colombia, and to the topics object of this presentation.

- Today there are 6 private funds with portfolios adding up USD 9.298 Mill., count with 5.6 million affiliates and 15.000 pensioners.

- Mandatory pension system is administered by private sector. Within the existent administrators, 42% is foreign investment, where the principal groups are: City, BBVA, Santander, IFC and indirectly Skandia. Only one administrator belongs to Colombian groups. Within these administrators, with a minority portion and induced by the Law, 6.5% belongs to familiar compensation funds´ sector.

- The option of having a pension and that the amount of it is a function of the accumulated capital along the person's life. Can quote to the system dependent and independent employees. In our country, from the 5.6 million affiliates to the private system, 44.4% are women and 55.6% are men. 84.5% of affiliates have a monthly income of less than USD 276, that is, two minimum salaries and 58% of those affiliates have an age not superior to 34 years. In the pay as you go system, the distribution is similar.

[4] Cajanal, Fonprecom (Congreso Fund), Caxdac (for pilots), Pensiones de Antioquia, Caprecom (for communication sector, is the oldest created in 1912).

- Affiliates to private pension system in Colombia are people relatively young, who will be pensioning in a significant volume from approximately 15 years. Therefore, Colombia's mandatory private pension system is in the accumulation stage and now is the time to make reforms and adjustments that the system needs in order to be viable and sustainable.

- Affiliates to mandatory private pension system save in individual accounts which administration and minimum profitability is the administrators´ responsibility.

- Minimum profitability, which has been questioned by many if it is by imitation or by conviction, has played an important role in our country. Every 36 months, it is calculated by the combination of one endogenous and one exogenous[5], which allows to mitigate the called "herd effect" ("efecto manada" or "mouton de panurge") that occurs in other countries where minimum profitability is calculated only as an average of the administrators themselves.

- Minimum profitability in our country has not impeded portfolio's diversification, nor has biased administrators´ investments towards the reference portfolio. Public debt concentration and today's administrators´ portfolio profile has the same limitations that the market does. That is, they are the reflection of a market that is scarcely liquid and profound. It is not minimum profitability the cause of these problems nor a generator factor of them, as has been demonstrated by the market's behavior, the funds´ portfolios and how the reference portfolio and minimum profitability have been.

- Eliminating minimum profitability and establishing a reference index o a market benchmark is not a solution for our market, because, as stated before, this benchmark would be the same that is used now as average of the funds. Our reference portfolio is constituted by the most representative bonds of the market and also combines OECD´s proposal by incorporating low risk and long term bonds, some indexed to inflation, and some with a plus, therefore having a reference portfolio or benchmark more

[5] The endogenous effect corresponds 70% to the average profitability of the system, and the exogenous effect is composed by 70% of the percentage raise in the BVC index, 70% of the percentage raise in the S&P index and 70% of the reference portfolio's profitability constituted by the S.B.C.

representative of the market. The structuring of our reference portfolio combines as well long term investment policies, with the least credit risk and the lowest possible profitability of the market, so that it penalizes the administrator that does not show a minimum of efficiency in affiliate's resources administration.

- Private funds supervision implies the appointment of various parameters by the regulator such as: Minimum credit risk qualification "BBB"; Maximum limits (never minimum) that allow to mitigate systemic risks and concentration in one issuer or in groups related to the administrator, such as: global limits (by economic sector), by issuer, by issuing, in linked companies, in shares from the same company; Secondary market negotiations through transactional electronic systems, and the prohibition to invest in bonds issued by the administrator, its matrix or subordinated.

- In Colombia, the faculty to issue or modify the investment regime for private funds relies in an entity that has an eminently technical character which is the "Superintendencia Bancaria de Colombia". This has allowed that the investment regime is not rigid though stable since it is adjusted to the actual conditions of the national and international markets. Maximum limits have not been a limit for administrators' investment.

- Since the creation of mandatory private pension funds, investment in shares and abroad was allowed, with the objective of authorizing the necessary tools for the conformation of low correlated and highly diversified portfolios, given the mentioned limitations of our local market.

- Mandatory private pension funds´ regulation has not led to a lower profitability for our market, compared to other alternatives less regulated such as voluntary (or complementary) pension funds, for example. Regulation has always sought the equilibrium between security, profitability and liquidity in portfolios.[6]

- Regulation of pension funds is migrating towards risk supervision. The administrator selects investments, values under standard parameters, there is not limit to VaR but there is the obligation to calculate it for control and

[6] Article 100 from Law 100 of 1993: "With the purpose of guaranteeing security, profitability and liquidity in the system resources, administrators will invest in the conditions and under the limits that for such effect establishes the Government through the Superintendency of Banks.

information purposes and risk qualification is established by an independent qualifying risk society.

- It can be concluded that the supervision over private pension funds has allowed for the construction and development of a trustable system.

PRINCIPAL CHALLENGES AND REFORMS THAT SHOULD BE ADOPTED AND CONSOLIDATED

- Increase in coverage: Although coverage should not be an objective for private pension funds, for whose challenge is to obtain with their administration the best possible pension for their affiliates, balancing security and profitability criteria, one of the Government's principal political challenges is to be able to integrate to the pension system the most number of people. Is evident that augmenting coverage requires the solution of many structural problems that our countries have, since without a sustainable growth that creates sources of labor, this coverage will remain to be an illusion.

- Consolidation of general pension system: The great challenge that our country has is to take the decision about either continuing with a dual system o adopting the creation of a first pillar for all affiliates over a small base (it has been thought maybe one minimum legal salary)[7], quoting in private funds a complementary sum. Nevertheless, if we recall the profile of our affiliates and their income, few of the actual affiliates could have quotation to private funds.

- Construction of a more equitable and sustainable system: For this is required: Elimination of special regimes (very few exist with very high pensions), bring forward transition regime in order to achieve as soon as possible equitable pension conditions for all Colombians, increase quotations, reduce benefits and refine information and data base to allow for a more agile and transparent system.

- Evaluation of replacement rate: Taking into account that the mandatory private pension system is in a stage of accumulation of resources, it is convenient to evaluate which would be its replacement rate, with the

[7] USD 138

experience of these 10 years of reform, with the aim to evaluate generated expectations with its implementation.

- Evaluation of the cost of having the minimum pension guarantee in charge of the State and the real possibilities that actual affiliates have to construct a pension: Although it is true that a minimum guarantee pension fund exists for mandatory private pension system that is constituted partly with the workers and employers quotations, is also true that is needed to evaluate the sufficiency of this fund, with the actual conditions of access to minimum guaranteed pension (57 years in women or 62 in men who have quoted over 1150 weeks[8]), because is the State who has to respond in the case that the funds of the guarantee pension fund result insufficient.

- Implement tax on pensions: It is of common knowledge that all people who today are receiving a pension did not quote enough to save the necessary resources that compensate it, given the generosities of the pay as you go system of then. For this reason, the Government is presenting a proposal to the Congress through which it can be imposed a tax on higher pensions that compensates in part the quotations that were not received and that avoids in the future an "intergenerational revolution", where new generations reject to assume the debt contracted by previous ones.

- Evaluation of the multi-funds scheme for the private pension system: Although it is true that multi-funds scheme has allowed for affiliates to distinguish themselves between averse or not to risk, and has allowed that they show a higher interest for their pension saving, the implementation of one of these schemes cannot be adopted as a general measure for all those countries that have private pension funds. In effect, a scheme of this type requires the evaluation of the particular market conditions of each country, the variable rent supply, the incidence of establishing minimum limits in most cases, instead of favoring affiliates it can prejudice them, by creating a fictitious raise due to a forced demand of bonds o by the losses in the event of a massive retire when, for example, variable rent has a significant fall in their prices.

- In general, strengthen reforms and a Supervision and control based in risks.

[8] From 2009, the number of weeks will increase in 25 every years until reaching 1.325 in 2.015.