Santiago, October 27, 2010

Mr.
Michal Rutkowsky
Sector Manager for Social Protection in the Europe and Central Asia Region
The World Bank

Dear Sir:

The International Federation of Pension Fund Managers wishes to express its concern for the decision being taken by some Central and Eastern European countries that have made reforms to their pension systems under the individually funded defined contributions mode, to consider returning to the former PAYGO systems.

Specifically, we have been informed of the tense situation the private pension industry in Hungary is experiencing as a result of the changes the government intends to introduce to its pension systems, which can be summarized as:

(i) Freezing the contributions to the individually funded program in the mixed pension system from November 1, 2010 until December 31, 2011;

(ii) Giving members who contribute to the Hungarian Pension System the immutable option of returning to the former PAYGO system.

As you are aware, the Hungarian PAYGO (pay-as-you-go) system was reformed in 1998. The reform added a second, privately managed, individually funded savings pillar to the existing pillar. This new Pension System, of a Mixed Complementary nature, is mandatory for all dependent and self-employed workers under the age of 42 who enter the labor force for the first time[1]. The overall contribution rate to this mixed system is 33.5% of the worker's taxable income, of which the employer finances 24% (which is fully paid into the PAYGO system) and the worker finances 9.5% (of which 1.5% goes to the PAYGO system and 8% to the individually funded account)[2].

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[1] After the introduction of the mandatory individually funded program, membership of a pension fund became mandatory for dependent and self-employed workers below the age of 42 who entered the labor market after June 30, 1998. All dependent and self-employed workers who had been in the labor market prior to that date had until August 31, 1999, to voluntarily decide whether they would remain in the former PAYGO system (pure PAYGO), or join the new mixed pension system. All voluntary members of the new system were allowed one opportunity to change their decision.

[2] For workers who belong to the pure PAYGO system, the contribution rate is 9.5% with the employer contributing 24% to make a total of 33.5%.

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Many Central and Eastern European countries, including Hungary, carried out meaningful reforms more than a decade ago, introducing private, defined contribution (DC) systems. The efforts made by these countries to consolidate their current pension systems is now being jeopardized by their governments' needs to reduce the public debt and fiscal deficits and comply with the objectives and agreements reached with the European Union and the International Monetary Fund (IMF), which has led some political and government sectors in such countries to propose the "dismantling" (quasi-nationalization) of the second pillar, with the subsequent return to the former PAYGO systems.

Nonetheless, we believe that it is a fallacy to think that the public debt will be reduced by such measures, for the following reasons:

- The fiscal problem being faced by most of the governments of Central and Eastern European countries is the result of the erosion of the assets of the former pension system and the recent financial crisis. The demographic factors faced by such PAYGO systems (increase in life expectancy and reduction in the fertility rate), have severely impacted them, making them unsustainable. The defined benefits of the PAYGO systems are in many cases higher than the contributions paid in by workers during the active stage, which is pressuring the countries with these systems to increase pension ages and reduce the benefits provided

- The financial sustainability of the pension programs was one of the main reasons why Central and Eastern European governments implemented the private, defined contribution pension systems, precisely because they needed to the improve the public sector deficit perspectives. Hence, the measures proposed by the current Hungarian government will only be exchanging one kind of debt for another, jeopardizing the mid and long term fiscal situation. They will be trying to solve a problem today at the cost of aggravating a problem in the future.

- There is an unequal treatment of the public debt in countries that have reformed their pension systems vs. those that have not reformed them. In the countries that have undertaken reforms, the "explicit" accountable public debt originates in the recognition by the government of the benefits of workers who contributed to the former PAYGO system and who in future must receive the pensions promised by such system. Nonetheless, in the countries that have not introduced reforms, this debt, referred to as "implicit," is not recorded in the government's accounting system, despite the fact that the creditors do exist.

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Consequently, FIAP believes that this "dismantling" (or "quasi-nationalization") of the pension funds that the Hungarian government is considering has negative consequences for the workers, for the pension system and for the economy of the country for the following reasons:

- The potential positive effect of the accumulation of pension funds on the economy (greater economic growth, deeper and more liquid capital markets, a larger number of financial instruments available for investment, lower transaction costs), depend to a great extent on the volume of accumulated funds. The lower the contribution rate to the individually funded pillar, the lower the volume of accumulated resources, and consequently, the lower such effects will be.

- This type of measures damage foreign investment in Hungary, since sudden changes in long term policy increase the perception of risks in the country's political and economic standing.

FIAP has considered it pertinent to express its opinions on these matters to the World Bank, convinced of the importance of consolidating and strengthening these new defined contribution pension programs created in Central and Eastern Europe, the majority of them with the support of the World Bank, due to their significant benefits for workers, the economy, the debt and the fiscal deficit of these countries. Our organization is at your disposal for collaborating on technical matters and providing our support for halting and/or avoiding these initiatives that affect the countries in the aforementioned region.

FIAP, created in May, 1996, is an international agency which brings together the associations of pension fund managers of the following countries: The Dutch Antilles, Bolivia, Bulgaria, Colombia, Costa Rica, Chile, El Salvador, Spain, Honduras, Mexico, Panama, Peru, Poland, the Dominican Republic, Romania, Ukraine, Uruguay and Venezuela. As of December, 2009, 105 million members were enrolled in FIAP member agencies, accumulating more than US$ 758,536 million in their respective individual accounts.

Sincerely,

Guillermo Arthur
President
FIAP

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