Communiqué

FIAP expresses its concern to the recent approval for reforming the Pension Law in Uruguay

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Given the recent approval of the reform of the Pension Law in Uruguay[1], FIAP wishes to express its concern regarding the effects it may have on the country's pension system:

- The reforms to the Individually-Funded Retirement Savings System approved by the Chamber of Deputies on October 23, 2013, will have a negative impact on the financial situation of the Social Security Bank (BPS), on the pensions of the members enrolled to the Pension Savings Fund Administrators (AFAPs) and the BPS, as well as on the investments of the pension funds and the macroeconomic growth of Uruguay.

- Reforms of this significance should be preceded by an in-depth analysis of the effects they could generate, and timely information regarding such effects on the different social and political stakeholders involved.

- When these conditions are not met, it increases the risk of the system not being able meet its essential purpose, which is to provide pensioners with adequate, stable and financially sustainable replacement rates over time.

- With respect to the process of approval of the reforms in Uruguay, there are no known studies on the actuarial impact of such measures on the financial situation of the BPS, and therefore on the amounts of the pensions that members of the PAYGO system managed by that agency may receive in the medium and long term. Its financial situation would probably improve in the short term, due to the eventual transfer of funds from the AFAPs to the BPS. However, it is highly likely that the financial situation of the BPS would deteriorate in the medium and long term due to the increase in the commitments to pay pensions, within a context of demographic trends that lead to a reduction in the ratio of assets to liabilities and an increase in the period for receiving a pension.

- Given the conditions set out in the law for deciding to voluntarily opt out of the AFAPs, there is uncertainty regarding the impact such decisions could have on the amounts of the pensions

[1] The most important modifications set out in this Law involve: (i) Revoking the option for the Mixed System: workers who were over 40 on April 1, 1996, could opt out of enrollment in the mixed system; (ii) Voluntary opting out of the Pension Savings Fund Administrators (AFAPs) for workers between 40 and 50 years of age. In order to determine in which cases it would be advisable to revoke this article, the BPS will mandatorily provide advisory services upon request, taking into account the work history and the retirement possibilities that the mixed system would provide the worker; (iii) Make it mandatory for members to process transfers before the AFAP they are enrolled in and not the target AFAP, as currently occurs; (iv) Promote the reduction of the commissions charged by the AFAPs by automatically assigning members, (those obligated to enroll but who do not choose an AFAP), to the fund Administrators with the lowest commissions. Members are currently assigned on the basis of the number of members enrolled in each AFAP, and with the proposed change they will be assigned to the two fund Administrators that charge the lowest commission in the market; (v) Allow retirees who return to formal employment to contribute only to the BPS, continuing to collect their pensions from the AFAPs; and (vi) Creating a two-fund system, in order to establish a "less risky Fund" to provide greater safety to members who are close to retirement. The bill of law provides for a gradual transition of the individual savings of workers from an "accumulation" sub-fund to another "retirement" sub-fund (safer) after they turn 55.

that workers will receive and the convenience of such opting out. Furthermore, the available information suggests that in a high percentage of cases such a decision could be harmful to those workers.

- The State is assuming an implicit responsibility for the effects that such decisions will have on the pensions of members, who will be mandatorily counseled by the BPS. There is a high risk that this advice may not be totally impartial or fully focused on the best interests of the members involved, since the decisions taken will have an impact on the short-term financial situation of the agency that mandatorily advises them. Moreover, even if the advice were absolutely impartial, there are many variables (period of payment of contributions, the return of the funds, etc.) that cannot be anticipated 10 to 20 years prior to the retirement age, which is when the decision must be taken. This entails, as already noted, high levels of uncertainty regarding the results that the decision to opt out can have on the pensions of members.

- It is worth mentioning that some of them might be especially disadvantaged if they fail to meet the minimum requirement of 15 years of contributions required by the rules and regulations to be eligible for benefits in the BPS, since in these cases they will lose ownership of the funds accumulated in the AFAPs and will not be entitled to receive a pension from the BPS.

- On the other hand, the immediate transfer of part of the balances accumulated in the AFAPs to the BPS during the first two years that the law is in force, and as members reach the age of 40 (and up to 50) and decide to exercise their right to opt out, may harm them and the rest of the workers enrolled in the AFAPs and the BPS. Indeed, the investment policies and the investment portfolios of the pension funds managed by the AFAPs must be adjusted to address the possible transfer of pension resources to the BPS, aiming for portfolios with a greater liquidity component, which will result in lower returns for the investments of the pension funds, with the consequent negative effect for those members who remain in the AFAPs.

- Furthermore, the liquidation of assets for transferring the pension resources from the AFAPs to the BPS will have a negative impact on the prices of financial instruments in the capital market, which will have an adverse effect on the accumulation of savings, financial development and the growth rate of the GDP (Gross Domestic Product). This is so because there is overwhelming evidence of the positive impact generated by the creation and development of the individually funded pension system and the accumulation of pension funds on the capital market and the economy in Latin America in general (see the Sura study "Contribution of the Private Pension System to the Economic Development of Latin America: experiences of Colombia, Mexico, Chile and Peru") (Spanish version).

- The authorization for the AFAPs to manage different funds or portfolios is a positive measure introduced by the reform, in line with the trends that can be seen in many other individually funded systems, enabling members to better adjust their investment portfolios to their personal characteristics and conditions, which may differ substantially between different segments. Nonetheless, the benefits of this measure are limited by the obligation of the AFAPs to transfer the accumulated balances from the Accumulation Sub-fund to the Retirement Sub-fund after 55 years of age. That obligation must be met, whatever the conditions existing in the capital market at the time of the transfers. This mandatory transfer requirement imposes on the State an implicit responsibility for the outcomes that such transfers generate in the pensions to be received by the respective members.

- Finally, this reform is not consistent with the trends evidenced in most of the European countries that have faced financial crises in the functioning of their PAYGO systems and the recommendations of international agencies, such as the OECD and the European Union, to advance in the development and strengthening of the defined contribution systems.

The International Federation of Pension Fund Administrators (FIAP) considers it positive that improvements are made to the pension systems as they develop, and that greater freedoms are granted to members for informed decision-making. However, such improvements must be based on a careful assessment of the effects that may be generated, especially in the amounts of the pensions of members and the long-term financial sustainability of pension programs, and they should be introduced after a process of in-depth analysis of such effects by different social and political stakeholders involved in the approval of the reforms.

The FIAP wishes to take this opportunity to make itself available to the authorities of the government and the pension funds of Uruguay, and collaborate in all initiatives for improving and strengthening the individually funded system.

FIAP, founded in May, 1996, is an international agency comprising the Associations of Pension Fund Administrators from the following countries: Bolivia, Bulgaria, Colombia, Costa Rica, Curacao, Chile, El Salvador, Spain, Kazakhstan, Mexico, Panama, Peru, Poland, the Dominican Republic, Ukraine and Uruguay. As of December 2012, more than 117 million workers were enrolled in FIAP's member associations and institutions, accumulating more than US$ 684,000 million in their respective individual accounts.

In Santiago, Chile, on November 7, 2013.

Signed by: The Board of Directors of the International Federation of Pension Fund Administrators (FIAP)

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