PENSION NOTES

No. 37 - SEPTEMBER 2019

NEW TRENDS FOR INCENTIVATING VOLUNTARY PENSION SAVINGS (VPS)

Executive Summary

Is it really necessary to encourage voluntary pension savings? Due to demographic changes (greater life expectancy and reduction in the birth rate), the drop in interest rates and market yields, among other factors, pension systems in the vast majority of countries are facing serious financial sustainability issues (PAYGO Systems) and providing pensions that fail to meet workers' expectations. Demographic changes will continue to evolve over the next decades, negatively and more severely affecting the finances of pension systems worldwide.

Increasing the retirement age and the contribution rate are parametric changes that allow pension systems to improve their financial sustainability and/or the levels of the pensions they grant, but in both cases, very unpopular legal changes are required, so governments usually tend to postpone their implementation over time, until a critical situation develops.

Given this reality, the only tool available to pension systems for addressing this negative situation is to encourage Voluntary Pension Savings (VPS).

FIAP therefore invited three experts to its 17th International Seminar[1] to share their opinions regarding the latest trends for encouraging VPS.

Francesco Briganti[2] comments that in the European Community (EC) voluntary

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[1] All the presentations of this seminar are available online: https://www.fiapinternacional.org/en/seminario/may-15-and-16-2019-17th-fiap-international-seminar-santiago-chile/

[2] Francesco Briganti obtained a doctorate in European law, majoring in the legal framework of a Pan-European occupational pension plan. He has spoken in more than 300 international forums and often delivers presentations as a visiting professor in a number of universities. He has worked as a European lobbyist for the workers' insurance and benefits sector for 13 years, and is currently the Secretary General of CBBA-Europe. He is a member of the Occupational Pensions Stakeholder Group of the European Insurance and Occupational Pensions Authority (EIOPA). He is the director of the Italian chapter of the International Association of Occupational Benefits (IEBA), and has been the director of the new European Union chapter of the agency since January 2019. Francesco is the CEO of the Employee Benefits and Welfare Institute, a public relations company based in Brussels (www.ebwi.eu).

pension savings focus on the second and third pillars, since the first pillar mostly comprises PAYGO systems with contribution rates close to 20% of wages. There is a high degree of consensus in the EC that mixed first-pillar (PAYGO/government funds + individual funding) or mandatory second-pillar pension systems are the best strategy available for achieving long-term sustainability, adequate pensions and intra and inter-generational solidarity. Hence, countries that operate a first PAYGO pillar with high contribution rates face more significant challenges when introducing a voluntary or mandatory individually funded component. He also refers to the seven strategies used for creating individually funded systems in the European context.

He emphasizes that current workers are much more reluctant to participate in intergenerational solidarity, which is the basis of the PAYGO pension systems. Young workers are increasingly in favor of individually funded systems. The above provides an ideal opportunity for objectively discussing the feasibility of introducing radical pension reforms aimed at remedying the balance between individually funded and PAYGO systems.

Renee Schaaf[3] comments that digital tools have enabled the pension industry to customize the provision of information to fund participants, thus, responding to the individual needs of recipients and capturing their attention. The use of *roboadvisors* has grown significantly in recent years and companies are using them to achieve an effective digital experience that addresses pension education, financial advice and the ability to permanently carry out transactions and interact. In the United States, the digital scenario is referred to as a "managed-account environment."

He comments on three recent experiences (China, USA and Chile) in which Principal has successfully used these tools. Perhaps the most notable case is CCBPAM, a joint venture with China Construction Bank for the massification of mutual funds in China. It used only traditional banking sector channels until 2016, but digital channel use was growing rapidly until it surpassed traditional channel use at the beginning of 2019.

He concludes by pointing out that pension sector companies that invest resources in improving their ability to present financial decisions in a more understandable format, through the use of electronic means - as well as providing the necessary information to captures the interest of the participants involved - will achieve greater market share.

Pablo Sprenger[4] points out that the expression "Voluntary Savings" is not

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[3] Renee is the head of Principal's financial services in the United States, i.e. the savings and pension income of thousands of employees, as well as millions of individual participants. Collaborating with multiple divisions in his company, he works on designing viable and durable solutions that address customers' requirements. Prior to his current position, he led operations, strategic planning and business development as Principal International's chief operations officer in Asia and Latin America. He has led commercial strategy, product development, technology, marketing, PAYGO and customer experience teams throughout his career. He has a bachelor's degree from Iowa State University (ISU), and an MBA from Drake. In 2016, he graduated from the Kellogg Global Advanced Management program (Northwestern University).

[4] Pablo Sprenger is an Industrial Civil Engineer graduated from the Catholic University of Chile, with an MBA from Kellogg School of Management. In his 20 years of professional career he has always been linked to the financial industry, mostly to the investment and savings sector, with different positions in the AFPs, Fund Managers and Financial Groups. After serving as the CEO of SURA Asset Management in Mexico for 5 years, he is currently the CEO of Sura Investment Management, the

entirely accurate, since it is not a voluntary activity today. On the contrary, it has become a basic requirement for people, since if one opts not to save, in addition to an individual account, in the current economic and regulatory scenario (contribution rates and retirement ages have not evolved in the last three decades), it is irrational to expect an adequate pension. Fund managers must encourage their customers to raise their savings rates from 10% to 20%, and there is only one tool available to do that: voluntary savings.

A very significant proportion of the population is not actively contributing to a voluntary savings account, so it is essential to increase the scope of financial advice. People do not usually act when they are not absolutely certain about making decisions involving such significant amounts. The restricting operational factor is that professional advice is very costly, so providing such advice to all clients under current conditions would not be feasible.

He concludes by pointing out that while mechanisms such as digital tools or collective savings plans are consolidating and the voluntary savings message is becoming simpler, making it understandable for ordinary people, it is urgent to inject more consultants - or a greater amount of advice - into the market. The main challenge is to ensure that hundreds of thousands of Latin American workers have access to an acceptable level of customized financial advice.

global investment division of SURA Asset Management, with operations in Colombia, Mexico, Peru, Chile, Argentina, Uruguay, Luxembourg and Australia.

I. Introduction

For the purpose of contributing ideas regarding the necessary reforms for increasing Voluntary Pension Savings (VPS) in the region, FIAP's 17th International Seminar included a panel of experts who provided an in-depth discussion of this important matter. This Pensions Note addresses the main aspects highlighted by Renee Schaaf, Francesco Briganti and Pablo Sprenger.

One aspect in which the three specialists agree, is the importance assigned to achieving significant VPS increases in the countries of the region.

II. Why is it important to increase VPS?

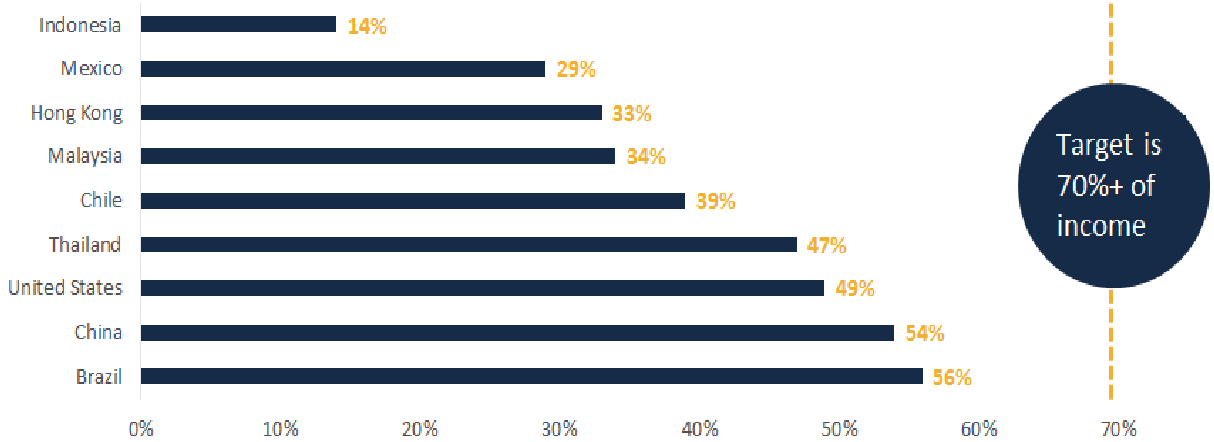
Renee Schaaf points out that a quick look at Graph 1 will suffice for understanding the importance of increasing VPS. The graph provides an excellent representation of the average net replacement rates in public pension plans. The gap between these replacement rates and the target replacement rate level of 70% could not be clearer.

Graph 1

Net average replacement rates in public pension plans

The role of voluntary savings is key to financial security

One cannot rely exclusively on public systems for achieving an adequate pension



* The pension systems included in this graph are mostly individually funded programs. The others are mainly PAYGO systems.
Note: Replacement rates corresponding to average income workers are projected assuming that they enter the labor market at age 20 in 2019, and retire at the official retirement age of their respective systems. For Brazil, the projections refer to the General Social Security System (RGPS); for Chile, to the AFP system; for China, they refer to the Basic Pension System for Urban Workers (BPSUP); for Hong Kong, to the Mandatory Provident Fund (*MPF*). for India, to the Employee Provident Fund (EPF), and the Employees' Pension Scheme, (EPS); for Indonesia, to *Old Age Security;* for Malaysia, to the Employees' Provident Fund (EPF); for Mexico, the Retirement Savings System (SAR); for South Korea, to the National Pension System (NPS); and for Thailand, to the Old Age Pension System (OAPS).
Sources: for Brazil, Chile and Mexico, *Pensions at a Glance: Latin America and the Caribbean;* for Chile, GAI calculations; for India, Indonesia, Hong Kong, Malaysia and Thailand, *Pensions at a Glance: Asia / Pacific 2013;* and for South Korea, Neil Howe, Richard Jackson and Keisuke Nakashima, *The Aging of Korea: Demographics and Retirement Policy in the Land of the Morning Calm* (Washington, DC: CSIS, 2007); The replacement rate for the United States is provided by the OECD.

On average, individuals need to accumulate sufficient savings to replace 70% of their income while active, if they intend to achieve financial security in retirement. A significant gap is observed in almost all countries when assessing pension situations in them. For example, the small sample of nations included in Graph 1 shows substantial deficits. In fact, countries that have been relatively successful in terms of their replacement rates, that are giving up their respective public pension plans, such as Brazil, China and the United States, have something in common: they are operating PAYGO systems, a completely unsustainable alternative, even in the midterm.

It is therefore essential to involve workers in improving the replacement rates they can achieve in the future with voluntary savings.

Francesco Briganti, on the other hand, concludes that the basic problem in Europe is that workers are currently contributing a very significant amount of funds to first-pillar pension plans, the vast majority of which are PAYGO plans. This significant cost, close to 20% of wages, makes the transition from a PAYGO system to a system containing individual funding components increasingly more difficult. On the other hand, it is essential to introduce individual funding components with a view to diversifying the revenues of the existing European PAYGO systems, in order to successfully address issues such as population aging, the increase in the demographic dependence rate and low fertility rates. This is only possible through voluntary savings in the second and third pillars.

Finally, Pablo Sprenger points out that the term "voluntary savings" is not entirely accurate, because it is not really a voluntary activity. On the contrary, it is a basic requirement for every economically active person. If one chooses not to allocate an additional percentage of one's income to an individual account, in the current economic scenario, it is irrational to expect an adequate pension in our Latin American countries, which have contribution rates that are half of those of OECD countries.

The elderly population has increased significantly in the last decades. We are facing increasingly low performance and yield results, and if we also consider structural factors such as informality and labor gaps, an unviable scenario for pensions emerges. Due to all the above, significantly increasing individual savings is not something that is voluntary in Latin America.

III. The growing importance of voluntary pension savings in Europe

For Francesco Briganti, above all, it is worth mentioning that the pension systems in the vast majority of European Union countries comprise 3 pillars:

First pillar pension systems: Created through national legislation, they are almost always mandatory, PAYGO, or funded with government resources; they are traditionally defined benefit.

Second pillar occupational pensions: Financed mainly with employers' contributions; comprising occupational schemes, they are usually individually funded and often voluntary, defined contribution or defined benefit.

Third pillar Individual pensions: Comprising individual pension agreements that constitute financial instruments. Available in a variety of national markets, these pensions are individually funded, defined contribution, completely voluntary and usually not employer-funded.

Voluntary pension savings focus on the second and third pillars. There is a high degree of consensus that mixed first pillar pension (PAYGO / fiscal resources + capitalization), or that a mandatory second pillar, is the best strategy available to achieve long-term sustainability of the pension system, adequate pensions, and solidarity (intra and intergenerational). Hence, countries that operate a first PAYGO pillar with high contribution rates face more significant challenges when introducing a voluntary or mandatory individually funded component.

There are currently seven strategies aimed at creating individually funded systems in the European context:

1. Tax incentives aimed at encouraging involvement in voluntary second and third-pillar individually funded systems;
2. Automatic enrollment in second pillar pension funds;
3. Collective agreements that favor enrollment in second pillar pension systems;
4. Structural first pillar pension reform, aimed at introducing individually funded pension systems;
5. Role of local or regional authorities in promoting pension funds countrywide;
6. New strategies aimed at establishing mandatory enrollment in second pillar pension funds;
7. Adjustments to the EU regulatory framework, in terms of the Pan-European Personal Pension (PEPP).

Almost all EU countries offer tax incentives for individuals and/or workers who choose to join a private pension fund. The most frequent fiscal alternative is an EET regime.[5] Nonetheless, other tax regimes similar to ETT are used in countries such as

[5] EET: An Exempt-Exempt-Taxed regime in which contributions and the returns on investments are tax-exempt, while the benefits generated are taxable on retirement. (Exempt contributions; exempt investment income, capital gains; taxed benefits.)

Sweden, Italy and Denmark.[6] The TEE (Luxembourg, Hungary, Czech Republic) and TET (Belgium, France, Austria) regulatory frameworks are also used.[7,8] Thus, while tax incentives are remarkably transversal, strategies vary from country to country.

The **second** main strategy is automatic enrollment. The United Kingdom was the first country in Europe to introduce this type of mechanism. Shortly thereafter, Italy introduced its version of automatic enrollment and Ireland has lately been preparing to introduce a similar mechanism. Automatic enrollment has proven to be useful in terms of generating very high efficiency, as well as boosting enrollment rates. All workers are subject to automatic enrollment, except when individuals expressly communicate their refusal to participate in the plan. Once again, the emphasis here is to focus on second pillar pensions. Employers therefore have a significant role to play in the process. If an employee chooses to remain in the scheme, the respective employer is obligated to pay a pension contribution.

The ability to withdraw funds from an occupational pension scheme before reaching retirement age varies in different European countries. Allowing an individual to use resources intended to cover his retirement pension, can evolve into a disastrous situation, by increasing the risk of living in poverty in old age. Alternatively, many consider a liberal regulatory framework a good strategy for increasing the attractiveness of initial enrollment in pension schemes.

The **third** strategy, especially prevalent in Scandinavian countries, and to a lesser extent in the rest of continental Europe, is the use of collective agreements to form pension funds. In continental Europe, such collective agreements may exist in a particular company, or in an entire sector. These agreements exist in economies such as Germany, France, Belgium, Holland and Italy. These types of agreements are mandatory in some countries, and optional in others. Thus, when agreements are not mandatory for all workers or employers involved, an alternative option is a referential pension plan generated through collective agreement.

In Southern Europe, as well as in the United Kingdom, collective agreements are usually weaker and almost never at a sectoral level. Companies and workers have the right to opt out of signing any specific agreement.

The **fourth** strategy is to introduce individually funded components into the first pillar. This type of structural pension reform has been quite common in Latin America, especially in Chile, where a system comprising exclusively individually funded accounts was introduced in the 1980s. Efforts for reforming the first pillar by reducing the PAYGO component and adding an individually funded component have been observed in other countries, especially in Central and Eastern Europe. These efforts to introduce pension reforms were very noble, but unfortunately, they frequently failed because - while employers were forced to assign their contributions to sustaining the PAYGO component - the workers chose to assign their contributions

[6] ETT: Exempt-Taxed-Taxed; i.e., contributions are exempt, while returns on investments and benefits are taxable.

[7] TEE: Taxed-Exempt-Exempt. Contributions: taxed. Investments: exempt. Benefits: exempt.

[8] TET: Taxed-Exempt-Taxed. Contributions: taxed. Investments: exempt. Profits: taxed

to the individually funded system. This process generated a huge deficit in the PAYGO system, since pensions still had to be paid to millions of pensioners. As expected, the PAYGO systems began to fail financially. Due to this situation, many governments chose to reduce the individually funded component of the first pillar, and some even chose to nationalize the entire pension fund. This was the case in Poland, Hungary and - more recently - in Romania.

Given this trend in several countries, it would appear to be preferable to introduce a pension reform aimed at generating an additional contribution to an individually funded system, as occurred in Sweden and Denmark, without restricting the financing of a PAYGO system that is still operational (or at least keeping such restrictions to a minimum).

The **fifth** strategy is related to regional initiatives. In extremely decentralized countries, and in some municipalities, some truly innovative public awareness and financial education programs have been introduced, and these regional and municipal entities have achieved much higher enrollment rates than their national counterparts.

The **sixth** strategy is to force individuals to participate in second-pillar schemes. This can be achieved by passing new legislation or by generating collective agreements that require the participation of all companies and workers in any specific sector.

The **seventh** and final strategy is the Pan-European Pension Product (PEPP). This personal pension product, approved in April 2019, aims at promoting the growth of the third pillar and its respective sector within the European Union, which currently has assets worth approximately EUR 7 trillion. The initiative is expected to increase competition among suppliers and promote the existence of a more dynamic voluntary savings market. On the other hand, it grants portability to the individual accounts of contributors who live or work in the EU member states, and more flexibility to companies that operate pension funds. For example, a company can open a pension fund in Luxembourg and then offer the product to individuals in European Union member countries.

Factors that can impede the growth of the voluntary pension savings sector in Europe

The relative magnitude of the first pillar PAYGO component in many European countries is a significant impediment to the introduction and proliferation of voluntary schemes. Indeed, many European countries use more than 20% of workers' income to finance the PAYGO component. This is a fairly high level when compared to the OECD average of 18.4%. The list of such economies includes Italy, France, Hungary, Poland, Latvia, Greece, the Czech Republic, Spain, Austria, Portugal, Estonia and Slovenia.

Another impediment is the situation where new generations have received lower salaries than previous generations, so it is more difficult to convince young people to save a percentage of their income in a pension account.

Public financial incentives are also expensive and European Union states usually have very high levels of public debt. This complicates the task of boosting the growth of the voluntary pension savings sector.

Society has undergone a paradigm shift in terms of public awareness campaigns aimed at fostering a retirement savings culture. Previous generations perceived pensions as a State-guaranteed right, so they were not an issue that merited a mass awareness campaign. The challenge is to convince current generations that pensions are a crucial matter and that minimizing their importance entails facing poverty in old age. Frankly, many societies have done little to address this issue. It is often easier to deny that a problem exists and continue as usual. Politicians are reluctant to face controversial issues, such as the fact that today's economically active population will not receive the same level of pensions as the previous generation.

Conclusions

To date, the evidence suggests that mechanisms such as automatic enrollment (tacit approval), proactive unions (collective agreements), and/or new strategies designed to legislate higher enrollment rates have provided better results than tax incentives.

The new PEPP initiative demonstrates the seriousness with which the European community is addressing the challenge of fostering a voluntary pension savings sector through a financial product that increases competition between the PEPP and existing domestic pension products.

The public pension debate has failed to adequately address the seriousness of the matter. Thus, the necessary level of awareness regarding the dynamics of the generation gap between the current population of pensioners and the generations that are working to support these senior citizens, is lacking.

The ideal strategy would be to reduce the level of contributions paid to PAYGO systems by young workers, with a view to giving them an opportunity to contribute to an individually funded system. This type of measure would have the added benefit of keeping labor costs under control.

A very gradual reduction in the contribution rate of PAYGO systems - for example, 1% for young workers - would be a very good starting point. Few politicians nowadays have the necessary courage to address the correlation between the pension amounts currently granted and the amounts of contributions paid. If we fail to directly address these issues, the intergenerational gap will simply increase over time and there are already unmistakable signs that young workers feel cheated by the existing situation. Not addressing this issue would therefore convert it into a time bomb.

Today's workers are much more reluctant to accept intergenerational solidarity, which is the basis of the PAYGO systems. In fact, these young workers are increasingly in favor of individually funded systems, while the credibility of collective and intergenerational frameworks is increasingly questioned. This scenario is a tremendous opportunity for reassessing the role of the State, employers, workers and the individual in generating income for retirement. Apparently, everything indicates that this moment in history is an ideal opportunity to objectively discuss the feasibility of introducing radical pension reforms aimed at remedying the balance between the individually funded and PAYGO systems.

IV. Voluntary savings: reinvented in the digital age

Renee Schaaf comments that determining the most effective way to connect with workers, with the aim of promoting more pension awareness, is a challenge that all countries face today. There is a great deal of empirical evidence that suggests that if one intends to incorporate a Voluntary Pension Saving (VPS) culture into the middle class, the workplace is the best place to start. Occupational pension plans are undoubtedly the best option currently available.

Another relevant and almost obvious issue is the proven effectiveness of the different mechanisms comprising such occupational plans: automatic enrollment; automatic increase in contributions over time; and automated financial instruments such as the Target Date Funds (TDF).

Digital media used responsibly have proven to be quite effective in informing and encouraging individuals to be more proactive in the construction of their pensions.

Promoting a voluntary savings culture through advice and digital sales

Digital tools have enabled the industry to customize the provision of information to funded participants. The ability to adapt the information to the situation and to the individual needs of recipients is fundamental. This is because pension advice, as well as other types of information, should call the attention of the contributor involved.

There are three fundamental objectives for measuring the effectiveness of a campaign or digital application aimed at increasing the level of voluntary savings:

The **first** objective of any digital system or program - whether live, telephonic or online - is to provide financial education that recipients can understand. If such individuals fail to understand the intended message, the effort will have been in vain.

The **second** objective is to provide concrete advice that is useful for making decisions. The majority of society is not made up of financial experts. We all need advice to determine what percentage of our income should be allocated to a pension savings account and the appropriate investment strategy for our risk profile. Historically, we have used human beings to guide participants in these instances. The only problem with using human advisors is that it is almost impossible to obtain the services of a qualified financial advisor to provide the necessary advice to structure a customized pension strategy, at an affordable cost for a middle-class individual.

The **third** objective, namely commercial aspects in terms of sales and customer service, is also extremely relevant when creating a digital strategy. One must ensure that participants are able to make decisions when interacting with a digital tool, and that such decisions are easy to execute. Under ideal conditions, no more than a couple of clicks should be required for performing a specific task.

These three components comprise what is characterized as an effective digital experience. In the United States, the digital scenario is referred to as a “managed-account environment.” The tools used for operating in this type of scenario are called *roboadvisors*.

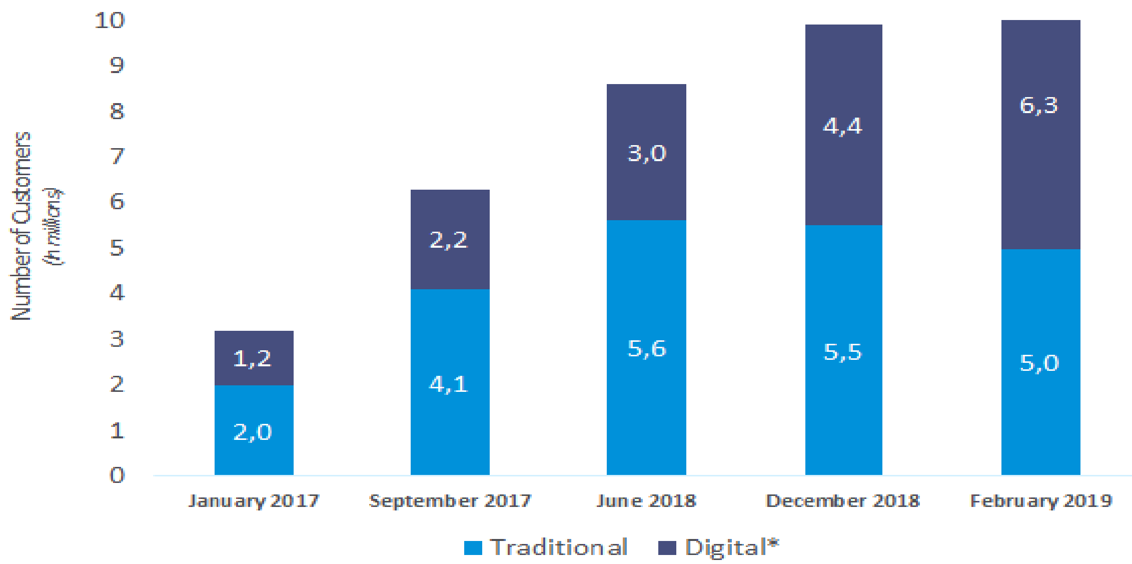
The evolution of the digital scenario

Renee Schaaf comments that Principal and China Construction Bank have a joint venture called CCBPAM, which specializes in massifying mutual funds in China. If one were to analyze the strategy used by a company like CCBPAM in the past, it would have been clear that the traditional banking sector channels were the default alternative for interacting with customers. I.e., if an individual wanted to enter a mutual fund, he would have chosen to visit a bank branch and talk to an executive. In this scenario, the bank would have recommended a mutual fund and the individual would have proceeded to perform the corresponding transaction.

This traditional paradigm is changing in the Chinese market. By the end of the first quarter of 2016, CCBPAM had not received a single client through the digital channel. However, as shown in Graph 2, digital channel participation grew rapidly until it surpassed the traditional channel. More than an *evolution* of the market, it has been a *revolution*.

One factor that contributed to the voluntary savings paradigm shift in the Chinese market is that CCBPAM chose to partner with the Alibaba digital platform, which has a commercial trajectory in Asia very similar to Amazon's presence in North America. The new level of visibility acquired in said portal was used to launch a digital platform for direct contact with consumers.

Graph 2
Evolution of digital channels in China
The revolutionary growth of investments through CCBPAM digital channels



* Digital customers include customers from Ant Financial and Tencent.
Source: CCBPAM data

This development is as interesting as it is promising, and even more so if we evaluate it in terms of the characteristics of the clients arriving at CCBPAM via the digital platform. These individuals are young: 55% are under 35 and are acquiring these types of products for the first time in their lives. Furthermore, there is a much smaller average amount of transactions involved. However, approximately 35% of customers chose to enroll in a systematic savings plan. Thus, while the monthly amounts involved are relatively low, transactions are occurring every month of the year. The cumulative impact of this type of behavior over time is very significant. It is the best indicator available for confirming the fact that the message one is trying to share is reaching the target audience.

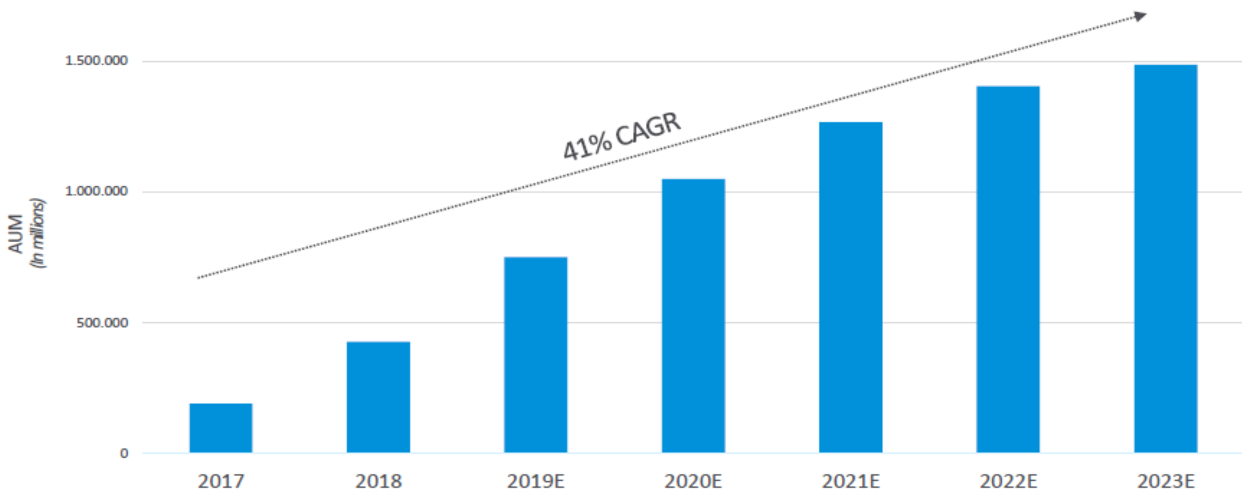
Digital platforms have experienced such an evolution that they are no longer seen as a superfluous aspect of a company's business strategy.

What is happening in other markets?

In the United States, we have seen similar increases in the level of interest in digital solutions. Graph 3 shows how the *roboadvisors* sector has evolved considerably within the US market. The term *roboadvisor* refers to a situation in which a company offers solutions through digital means, with a view to addressing three elements: pension education; financial advice; and the ability to permanently carry out transactions and interact.

As can be seen, the evolution of the US sector has been significant, but the observed results do not even approximate what we have seen in the Chinese case. Logic would indicate that the determining factor is quite simple: in terms of performing daily tasks, Americans often incorporate technology at a slower rate than their counterparts in China.

Graph 3
Roboadvisors: Assets under management in the United States (millions of USD)



Source: Statista, February 2019.

The product was introduced by Principal and some data have already been collected, although it should be noted that they are extremely precarious.

To address this issue in the US market, Principal is using the “managed-account environment” technology, to cover events that occur during a person's lifetime, such as job changes or reaching retirement age. Thanks to this initiative, the company currently has the ability to offer its customers - through their cell phones or computers - the option of performing an electronic pension transaction. The process is extremely simple in that it usually does not require more than two clicks to perform and the alternatives offered to contributors are based on their risk profile and the other basic personal data of the customer that the company possesses. This strategy allows recently retired pensioners to reinvest all income for retirement that they have accumulated in a 401(k) account, or through an occupational pension plan, in a customized pension account. Additionally, the ability to present this alternative precisely when an individual retires, ensures that he does not lose any of the available tax benefits by choosing to invest his resources in a pension account.

The initiative was introduced through what is known as a soft launch, in March 2019. A soft launch is a low-profile initiative, which is less focused on measures such as media campaigns. In fact, CCBPAM opted to simply add the tool to the institutional portal and wait to see how many customers started using the tool through their cell phones or laptops.

The results of the eight weeks of operation have been quite promising. There are now approximately 130 accounts and USD 8 million in assets, which constitute pension resources from 401 (k) accounts deposited in an individual pension account.

The strategy used was to focus almost entirely on generating a digital tool that, together with the decision-making process, was intuitive and as least scary as possible. The scope of decisions involved here is quite considerable, so it is convenient to simplify rather than complicate. Most people do not understand all the details that differentiate fixed income from equities. When one adds the ramifications of longevity, market and interest rate risks, it is easy to understand why it is completely irrational to expect that most individuals would understand all the parameters involved. It is therefore not rational to expect that the results achieved by these individuals will be optimal, if they do not have professional advice.

Companies in the pension sector that invest resources in improving their ability to present financial decisions in a more understandable format, through the use of electronic means - as well as providing the necessary information to captures the interest of the participants involved - will achieve greater market share. This is an exemplary case of how to optimize the use of the managed account environment within a pension's context.

And it is not the only example. There are a broad variety of examples of initiatives being introduced into the market, on which data are beginning to be collected.

Very similar results have been observed in Chile. AFP Cuprum launched a cell phone application in April 2019, as part of a broader strategy aimed at optimizing the ability to interact with members more significantly. It is part of the strategy aimed at informing members of their projected pension amounts. The application also makes it possible to simplify the way in which fund participants perform transactions, in the place and at the time they deem appropriate. All they need is a cell phone and the AFP Cuprum app. This cellular application provides an opportunity for the company to optimize the processes by which information is delivered to members. Only two weeks after the launching, more than 35,000 people had downloaded the app.

Thus, we know that this set of digital tools are a provenly effective alternative, and that the Chilean public is open to the possibility of using and incorporating these types of tools. The question is why more companies in the sector are not introducing these types of measures? It is time for the pension industry to incorporate digital platforms: the rules of the game are changing.

V. The secret (and politically incorrect) ingredient behind the ongoing success of voluntary savings

Pablo Sprenger puts forward four central messages. To begin with, he points out that the expression "Voluntary Savings" is not entirely accurate, since it is not a voluntary activity today. On the contrary, it is a basic requirement for each economically active person. If one chooses not to allocate an additional percentage of one's income to an individual account, in the current economic scenario, it is irrational to expect to receive an adequate pension. Fund managers must encourage their customers to raise their savings rates from 10% to 20%, with such action not being a voluntary alternative, but a fundamental component in terms of financing and building their future pensions.

The second message is that there is a debt in terms of voluntary savings within the Latin American region, corresponding to regulators, legislators, companies, the media, as well as individuals. Society has grown comfortable due to the high growth rates of assets under management (AUM) by the AFPs. This indicator has increased for many years, causing people to forget that there is a very significant proportion of the population that is not actively contributing to a voluntary savings account.

It is essential to increase the scope of financial advice. This is crucial if we intend to change historical trends. People do not usually act when they are not absolutely certain about making decisions involving such significant amounts. Empirical evidence suggests that the only solution we have in a free society is to increase the level of financial education of our populations. All other factors are less determining. While other strategies aim at treating the symptoms, more informed individual participants are the only lasting solution for treating the root of the problem. The restricting operational factor is that professional advice is very costly, so providing such advice to all clients under current conditions would not be feasible.

Bearing the above in mind, the time has come to start thinking outside the box. Decades ago, the sector invested a lot of time and resources evaluating and analyzing factors such as tax benefits, liquidity of savings, automatic enrollment and business plans. While it is indisputable that they have been extremely successful for people with access to voluntary schemes, they have not been able to remedy the main challenge: to propagate a culture of additional retirement savings.

And why is it so imperative to address this issue immediately? In the absence of any fundamental change in the regulatory framework, truly innovative solutions are our only tool for addressing current levels of discontent. For example, if we intend to make changes in the retirement age, the legislative option is the only one available. The same applies if one intends to increase the contribution rate. Changes that have a significant and lasting impact are always the most difficult to implement. The pension sector has only one tool available for making the necessary changes: voluntary savings.

So, if the industry intends to use voluntary savings to change pension realities to help citizens access adequate pensions, it will have to change the way in which the issue of voluntary savings is addressed.

Another very important factor is the fact that people do not know how to save and/or do not want to. If the sector does not choose to wake up or raise awareness, even regarding the pension gap we will face in future, that trend will continue. That is why it is necessary to change the paradigm of the so-called voluntary savings.

The possibility of obtaining adequate pensions for a significant percentage of the population is an increasingly complex challenge. For example, the intergenerational dependency rate is becoming less viable by the day and the pension sector has done almost nothing to address the issue within the region.

How does one cover the pension gap?

Voluntary savings have proven to be an effective tool in terms of remedying the pension gap that exists in our countries.

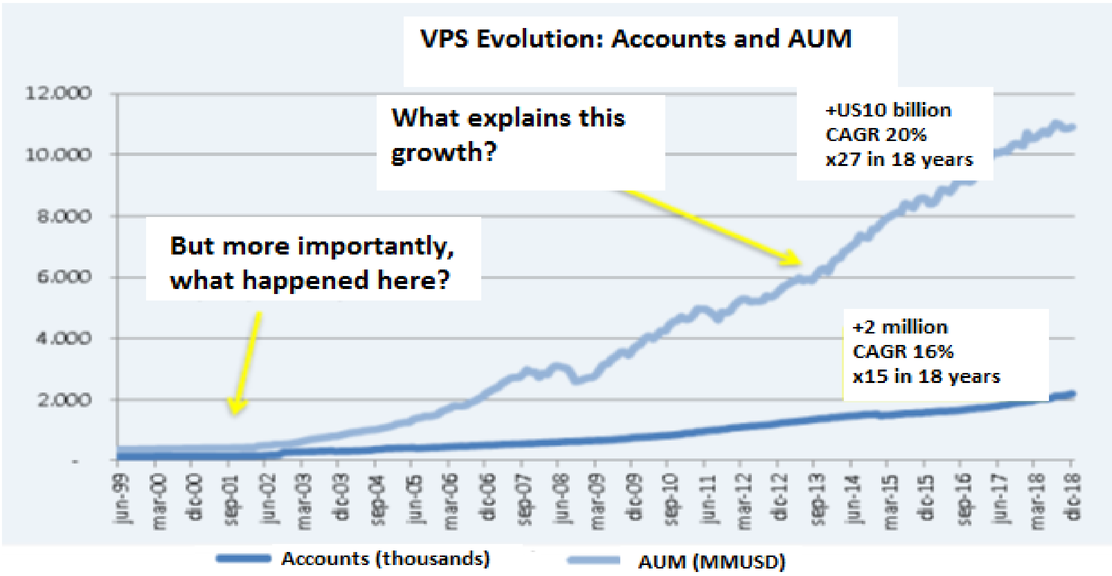
First of all, one must very clearly define the criteria suitable for evaluating the success of VPS. Growth is a very common indicator, but it is rather misleading in cases involving a very small initial base. Marked increases in the growth rate can lead to an erroneous perception of ostensibly successful results.

The amount of assets managed is also very frequently used to measure growth rates. But clearly, the amount of assets under management does not indicate anything in terms of coverage or the scope achieved, since they include people who do not need voluntary savings, because they have more assets under management (AUM).

The number of plans available, coverage and improvement of pensions - i.e., voluntary savings as a percentage of pension growth - are very relevant factors when determining advances in VPS.

Chile is an especially appropriate case in terms of illustrating the importance of understanding the criteria for success. As shown in Graph 4, Chile has experienced a very high level of perceived success. Assets under management, among others, have grown at an annual rate of 20%. We are talking about assets exceeding USD 10 billion, which have multiplied 27 times over a period of 18 years. The Chilean case has undoubtedly generated many signs of successful behavior for many years.

Graph 4



Source: Sprenger (2019).

We started with more than 2 million accounts, but this figure rapidly collapsed to a total of 425 thousand when we eliminated accounts with zero balance, or balances with no significant bearing on pension increases, or those with no movement in the last year. This shows that the gap between perceived success and reality is important.

As can be seen in Figure 4, something very significant happened in 2001 that changed the historical trend of assets under management.

The legislative change in 2001 only formalized and ordered existing tax benefits. The two major changes were, on the one hand, the possibility of charging for the management of VPS accounts was introduced and, on the other hand, new competitors (banks, insurance companies, mutual funds) were allowed to enter the VPS market. I.e., before this change the AFPs could not charge for the management of VPS accounts and since the product did not generate income, they did not promote it.

In 2001, free competition was introduced in the VPS market, incorporating charges on managed funds and allowing new competitors to enter the market. Thus, private initiative is the secret and very politically incorrect ingredient that boosted the voluntary retirement savings sector.

So, while the main actors in the pensions sector have focused on traditional mechanisms (tax benefits, automatic enrollment, price reduction, digital media aimed at facilitating access), nobody has been concerned with emphasizing the purely capitalist component that was the engine driving all the success we have seen since 2000. The personal advice that the funds have provided to their clients is what has made the difference. The vast majority of participants are in the voluntary savings system because someone sat down at a table and explained the benefits of participating in a VPS account. In addition, personal counseling provides an opportunity to contextualize the risks of not taking action; i.e., the risks of not opening a voluntary savings account.

Making an analogy between VPS and sports

If one offers a sports program with all possible discounts - which in this instance would be equivalent to a tax benefit - would you start training tomorrow? If you don't even need to sign up in the gym on the corner, because there is an automatic enrollment mechanism for all the neighbors, would you choose to visit that gym today? I.e., if we eliminate all procedures and paperwork, what is the impact of this measure on your decision to start sweating and making an effort?

Now, let's adjust the parameters. What would be your reaction if a doctor tells you that you are going to die if you do not start a physical activity program immediately? There would be a very limited percentage of the population that would choose to do nothing after receiving such a serious warning. However, most would take action and change their lifestyles. The doctor is similar to the VPS financial advisor.

Another important aspect is that financial advice has usually concentrated on clients requiring advice on tax matters, as well as clients with fairly high savings capacities, giving rise to a scenario in which few clients managed to increase their voluntary savings balances very significantly. Furthermore, this strategy still gives very successful results in that customer segment. However, the main flaw in this type of strategy is that the pension sector is not capturing almost 80% of participants available in the market and these individuals are therefore not enjoying these significant results in terms of generating wealth. for retirement.

Obviously, this situation can be interpreted either as an opportunity, or as a necessity. While mechanisms such as digital tools or collective saving plans mature, the degree of consolidation has been well below optimal. The sector is still in the initial stages in these types of measures. It is urgent to inject more consultants - or a greater amount of advice - into the market. The main challenge is to ensure that hundreds of thousands of Latin American workers have access to an acceptable level of customized financial advice.

Conclusions

It is urgent to simplify the process of managing a voluntary pension savings account. To achieve this, one has to simplify the discourse, because nobody understands it. This is not a socio-economic issue. This is evidence that this is a fairly complex product, and the industry therefore needs to focus on how to present it to the public. This strategy will clearly require a lot of thought, innovation and inspiration. It is one of the biggest challenges for promoting a retirement savings culture.

As we address the key issues such as automatic enrollment, greater and better use of technology, simpler products and innovative marketing, we cannot lose sight of the main objective: simplify. Once simplification is achieved, it will be time to encourage the growth of the culture of VPS sector.

In order to encourage and boost the growth of this sector, one must address the issues of portability and liquidity in special cases, relevant tax incentives for the company, as well as workers, a stricter regulatory framework in terms of converting voluntary plans into something more mandatory, and evaluating supply subsidies with a view to maximizing coverage.

It is about starting the process of change and not staying on the beaten path. We must start providing advisory services. That will require innovative solutions, because everyone in the sector knows that it is simply not viable in economic terms at present.

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