PENSION NOTES

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Melbourne Mercer Global Pension Index 2019: Lessons for Latin America

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Executive Summary

The Melbourne Mercer Global Pension Index, which assesses the pension systems of 37 countries, shows that Latin America faces significant challenges in that area. Chile ranks 10th among the best countries in the world, with 68.7 points in a scale of 100; Peru 19th, with 58.5 points; Colombia 20th, with 58.4 points; Brazil 23rd, with 55.9 points; Mexico 33rd, with 45.3 points, and Argentina second-last, with only 39.5 points.

This Pensions Note analyzes the results of the pension systems of these countries in each of the sub-indices comprising them, namely **Adequacy, Sustainability and Integrity**, the weaknesses of the aforementioned Latin American pension systems, and the reforms or improvements they require.

Chile has good Sustainability and Integrity indicators, even though the Adequacy indicator is slightly below the average of the countries analyzed, pointing to an opportunity for improvement in this indicator, which, among other things, compares income and benefit levels.

Peru with a global index slightly below the average of the other countries, has an above-average assessment of its Sustainability indicator, but a low Integrity assessment, partly due to the low coverage of its pension system, and an assessment slightly below the average in Adequacy.

Colombia and Brazil have Adequacy and Integrity indicators above the average of other countries, and a low Sustainability indicator, particularly low in the case of Brazil, due to the significant deficit of its PAYGO system.

Mexico has a good Sustainability indicator assessment, but significantly below-average assessments of its Adequacy and Integrity indicators, due to the level of benefits it can provide with a contribution rate of only 6.5% of wages and the low coverage of its pension system.

Finally, Argentina is ranked second-last in the Mercer index because its three sub-indices are significantly below the average of the other countries assessed, indicating that its pension system is in urgent need of deep reform. It should also be noted that in general, the assessments of Latin American countries dropped slightly with respect to the same report of the previous year, perhaps as a reflection of the little progress in the reforms they require.

I. Introduction

The 2019 Melbourne Mercer Global Pensions Index was recently announced. In this edition, it celebrates its eleventh anniversary since its launching in 2009, when it analyzed the pension systems of only11 countries, compared to the 37 countries it now covers, representing more than 63% of the global population.

The Mercer Global Pensions Index reveals the countries with pension systems that are more and less prepared to face a future of population aging, through three sub-indices: **Adequacy, Sustainability and Integrity**, with more than 40 indicators.

In the Adequacy or Sufficiency sub-index, it considers indicators such as benefits in the safety net to protect the most dispossessed, the net replacement rate, the existence of a minimum retirement age, whether pension savings withdrawals are allowed prior to retirement, the portability of benefits when workers change jobs, the design of the system, tax benefits, home ownership, long-term return on investment and asset growth. It has a 40% Global Index weighting.

The Sustainability sub-index focuses on the future, on the probability of the system being able to continue delivering existing benefits; it considers indicators such as pension coverage, the retirement age, labor force participation rate, total assets, contribution rate, Old age dependency rate, coverage of private pensions, government debt and economic growth,

The Sustainability sub-index focuses on the future, on the probability that the system can continue to deliver current benefits, considers indicators such as pension coverage, pension age, labor force participation rate, total assets, contribution or contribution rate, old age dependency rate, private pension coverage, government debt level and economic growth. with a 35% weighting.

Finally, the integrity sub-index is weighted at 25% and considers indicators such as regulation, governance, the risks of pension plans, information or communications and costs.

Table No. 1 shows the value of the index, country-by-country, from highest to lowest, together with the value for each of the three sub-indices.

. Each index value represents a score of between 0 and 100.

The index shows that the Netherlands and Denmark, with scores of 81 and 80.3 respectively, offer the best retirement systems, with sustainable benefits and a high level of integrity, which clearly demonstrates their adaptation to population ageing.

Nonetheless, the results regularly revealed the growing tension between the Adequacy and Sustainability of pension systems. This was particularly evident when examining the European results. Denmark, the Netherlands and Sweden obtain high Adequacy and Sustainability scores, whereas Ireland, Germany, France, Spain Austria and Italy have good Adequacy assessments, but poor sustainability assessments (less than half of the average of the other countries).

Table No. 1: Assessment of the Melbourne Mercer Global Pension Index, based on sub-indices

Ranking	System	Overall value of the 2019 index	Values of the 2019 sub-indices		
			Adequacy	Sustainability	Integrity
1	Holland	81	78.5	78.3	88.9
2	Denmark	80.3	77.5	82	82.2
3	Australia	75.3	70.3	73.5	85.7
4	Finland	73.6	73.2	60.7	92.3
5	Sweden	72.3	67.5	72	80.2
6	Norway	71.2	71.6	56.8	90.6
7	Singapore	70.8	73.8	59.7	81.4
8	New Zealand	70.1	70.9	61.5	80.7
9	Canada	69.2	70	61.8	78.2
10	Chile	68.7	59.4	71.7	79.2
11	Ireland	67.3	81.5	44.6	76.3
12	Switzerland	66.7	57.6	65.4	83
13	Germany	66.1	78.3	44.9	76.4
14	United Kingdom	64.4	60	55.3	84
15	Hong Kong SAR	61.9	54.5	52.5	86.9
16	Malaysia	60.6	50.5	60.5	76.9
17	United States	60.6	58.8	62.9	60.4
18	France	60.2	79.1	41	56.8
19	Peru	58.5	60	52.4	64.7
20	Colombia	58.4	61.4	46	70.8
21	Poland	57.4	62.5	45.3	66
22	Saudi Arabia	57.1	59.6	50.5	62.2
23	Brazil	55.9	71.8	27.7	69.8
24	Spain	54.7	70	26.9	69.1
25	Austria	53.9	68.2	22.9	74.4
26	South Africa	52.6	42.3	46	78.4
27	Indonesia	52.2	46.7	47.6	67.5
28	Italy	52.2	67.4	19	74.5
29	Korea	49.8	47.5	52.6	49.6
30	China	48.7	60.5	36.7	46.5
31	Japan	48.3	54.6	32.2	60.8
32	India	45.8	39.9	44.9	56.3
33	Mexico	45.3	37.5	57.1	41.3
34	Philippines	43.7	39	55.5	34.7
35	Turkey	42.2	42.6	27.1	62.8
36	Argentina	39.5	43.1	31.9	44.4
37	Thailand	39.4	35.8	38.8	46.1
	Average	**59.3**	**60.6**	**50.4**	**69.7**

Source: Based on the Melbourne Mercer Global Pension Index, 2019, page 7.

This study lists the reforms that can be implemented to improve the long-term results of pension systems:

- Increase the official state pension or retirement age, to reflect the increase in life expectancy, reducing costs for financing pensions.

- Promote greater participation of the elderly in the workforce, which will increase the savings available for retirement and limit its duration.

- Increase private savings, to reduce dependence on public pensions, while also adjusting the expectations of many workers.

- Increase the coverage of employees and/or freelancers, recognizing that many people will not save without a mandatory component or automatic enrollment.

- Reduce the leaks in the savings system prior to retirement, ensuring that the funds saved are used entirely in the provision of retirement income.

- Review the degree of indexation of public pensions, simultaneously maintaining the real value of pensions, in a balanced manner, with long-term sustainability.

- Improve governance and enhance the transparency of private plans, to generate greater confidence among members.

II. The situation in Latin America

According to the Melbourne Mercer Global Pension Index, Chile ranks tenth in the world, with 68.7 out of a possible 100 points; Peru ranks 19th with 58.5 points; Colombia 20th, with 58.4 points; Brazil 23rd, with 55.9 points, although it has the most robust system of individually funded complementary corporate plans in the region; Mexico ranks 33rd, with 45.3 points, and Argentina ranks second-last, with only 39.5 points, given the shortcomings of its retirement planning systems, which question their sustainability. On comparing the results with those of the previous year, an overall decline in Latin American countries is observed, possibly because no relevant reforms had been approved in those countries at the time of the report.

All of the Latin American countries included in the Melbourne Mercer study are analyzed individually below.

Chile ranks tenth, mainly due to the maturity and the adjustments made to its innovative AFP model implemented in the 80s, and subsequently implemented by other countries. The assessment is mainly due to good Integrity and Sustainability indicator scores. Nonetheless, its Adequacy indicator scores slightly below the average of the countries analyzed, pointing to an opportunity for improvement in this indicator, which, among other things, reflects benefit vs. income levels.

It seems that the Chilean government shares Mercer's diagnosis, since laws aimed at increasing pension amounts are currently in the legislative process. Among other aspects, the contribution rate will gradually increase by 5 percentage points (according to the government's latest announcements), bringing it closer to the rate of OECD countries and enabling an almost 50% growth in individually funded pensions; the benefits of the Solidarity Pillar (Basic Solidarity Pension and solidarity Pension Contribution) will be raised by more than 20%, mainly benefiting low-income individuals who have not contributed to their pension, or have done so sporadically; additional State contributions are created for middle-income workers who have regularly contributed to the pension system; a subsidy and dependency insurance is established for senior citizens requiring assistance from other people to engage in basic daily life activities, and incentives for people to voluntarily postpone their retirement, thereby increasing their pension amounts. Furthermore, after a drawn-out process, a law was finally passed that makes it mandatory for self-employed workers who issue fee slips to gradually start paying social security contributions. The Government is also studying the incorporation of other self-employed workers into the social security system.

Although it surpassed Colombia's assessment, Peru's overall index dropped from 62.6 to 58.5 between 2018 and 2019, with drops in its 3 sub-indices, but even more so in Adequacy, which is related to benefits and is below the average of the countries analyzed in this report. The Sustainability and Integrity sub-indices are slightly above and below average, respectively. Peru needs to increase the coverage of pension plans, which currently cover only 17.3%[1] of workers; improve the level of benefits granted by the non-contributory pension program "Pension 65", to financially support the poorest senior citizens; it must also review the contribution rate, which is similar to the Chilean rate, and encourage voluntary pension savings. But the most urgent requirement is the elimination of the lump sum withdrawal of 95.5% of accumulated pension savings by individuals who retire early, or at the official retirement age.[2], which has been used up by 95% of Peruvians, leaving them and their families without health coverage or the protection of a pension. Likewise, the withdrawal of 25% of the pension funds to finance initial down-payments or amortization of mortgage loans (housing), which around 50,000 Peruvians have already done, must be restricted. Housing is undoubtedly an important necessity, which must be resolved, but it should not be done at the expense of pensions, since low pension contribution rates do not suffice for financing other benefits, however laudable they may be.

Colombia dropped from 62.6 to 58.4 in its overall index between 2018 and 2019, with drops in its 3 sub-indices, but like Peru, even more so in Adequacy, which is below the average of the countries analyzed in this report. The Sustainability and Integrity sub-indices are both below the average of the countries analyzed. Thus, the improvements to its pension system necessarily involve increasing the coverage of pension plans, which currently cover only 35.9% of workers; raising retirement ages based on life expectancy increases; increasing minimum support levels for the poorest and household savings levels; restructuring the two parallel

[1] 17.3% coverage refers only to contributors of the private pension system, without taking into account 93% of the public system. (contributors/EAP). If the number of members is taken into account, coverage is 38% in the private system and 26% in the public system. (members/EAP).

[2] More than 100,000 Peruvians have withdrawn 95.5% of their pension savings in recent years, 35% at the official retirement age and the remaining 65% in advance,

pension systems (PAYGO[3] and individual funding), which are mutually exclusive, towards a sole individually funded contributory system, which eliminates the arbitration of the most informed iindividuals, the growing public deficit and strong regressivity due to the existence of "special" pensions that provide disproportionate benefits to certain population groups, focusing the State's efforts on the administration of protection to the most needy (PEBS and Colombia Seniors). The Colombian Government has announced that it will send a Law to Congress sometime next year.

Brazil was below the average of the global sample, mainly due to the poor result of the Sustainability sub-index, because its social insurance system works as an unfunded defined benefit plan, both for public and private workers, with pension expenditure equivalent to 13.6% of GDP in 2017 (with a deficit of 4.25% of GDP), which would have grown to 23% of GDP by 2060, if no reforms had been implemented. This is despite the fact that Brazil has the largest volume of retirement savings assets in the region in the individual and complementary corporate savings plans. Congress recently passed the Law reforming the pension system, which, among other aspects, establishes minimum retirement ages of 62 and 65 for women and men, respectively, in one of the only countries in the world where there was no such requirement and where women and men retired at 53 and 57, respectively, on average. The generous pensions that mainly benefited Brazilian workers in the formal sector, and the accelerated aging of its population, generated a time-bomb in public finances. In 2018, social security expenditure was 44% of the government's budget and 8.6% of GDP (which would have reached 17% of GDP without the reform), all of the above with a fiscal deficit of 8.6% of GDP.

Mexico appears further down in the Melbourne Mercer Global Pension Index, with Argentina second-last on the list, among the pension systems that "have significant weaknesses or omissions that need to be addressed. Without these improvements, their efficacy and sustainability are in doubt."

Mexico maintains its overall 2018 assessment, with minor changes in its 3 sub-indices. The Suitability sub-index, which records the adjustment of the universal pension, is where Mexico has the lowest score, with 37.5 points. Improvements are possible by increasing contribution rates to the individually funded system, since with a contribution rate of only 6.5% of salary, it is very difficult, if not impossible, to provide quality pensions. Calculations performed by several Institutions indicate the need to increase the mandatory contribution rate to 15%, starting now and gradually increasing over the next 5 years. Other areas requiring regulatory improvements are:

- ✓ Make the AFORE investment regime more diverse and flexible, particularly the maximum limit in foreign securities investments (currently 20%) and securities lending, in order to structure better portfolios, improving returns and diversifying risks.
- ✓ Update the mortality tables in accordance with demographic data. The last adjustment was in 2009, based on data provided by the IMSS and the ISSSTE.
- ✓ Standardize the legal and regulatory framework of all pension plans, aiming to establish a truly national and equal Pension System for all Mexicans, including the rules governing private and public sector pension plans and special pension

[3] Known as the Average Premium Plan (*Régimen de Prima Media*), whose deficit was 4% of GDP in 2017.

plans (state administration, municipal and university, among others).

- ✓ Merge the SAR with the non-contributory program (universal pension for the elderly). It is important to incorporate the non-contributory pension into the contributory system, in order to improve coverage and replacement rates and reduce incentives for labor informality.
- ✓ Increase voluntary savings. Providing incentives for voluntary savings is a pending task. Voluntary savings, automatic enrollment of workers with the possibility of opting out, and matching contributions by employers, have given positive results in other countries.
- ✓ Prepare the decumulation phase (in 2021 the first workers will retire under the Afores system): The first generations to retire under the individually funded system will be those affected by low replacement rates, so the gap between their benefits and the benefits received by pensioners of the former regime will be glaringly evident. So, despite the reform, which will have a long-term effect, solutions must be found to attend to these first generations.
- ✓ Expand and improve the services provided by the AFOREs to workers.
- ✓ Deepen the financial education and pension culture of Mexicans.
- ✓ Incorporate freelancers.

Argentina ranks second-last in the Mercer index, surpassing only Thailand, which only this year joined the list of countries assessed, because its three sub-indices, namely Adequacy, Sustainability and Integrity, are significantly below the averages of all countries assessed, indicating that its pension system is in urgent need of deep reform.

It is important to remember that in 2008, Argentina eliminated the individually funded system that was created in 1994 (which was based on the Chilean model). All workers' savings accumulated in the Pension Funds Managers (AFJPs) were expropriated and transferred to the National Social Security Administration (ANSES), a government agency, which adequately financed the payment of PAYGO pensions with these resources, although public spending more than doubled in the last decade to finance its considerable deficit, which amounted to 11.3% of GDP in 2017. In fact, pension expenditure in 2017 was almost half of the government's total public expenditure and revenue from contributions to the pension system accounts for only 60% of pension payments (see FIAP Pensions Note No. 34).

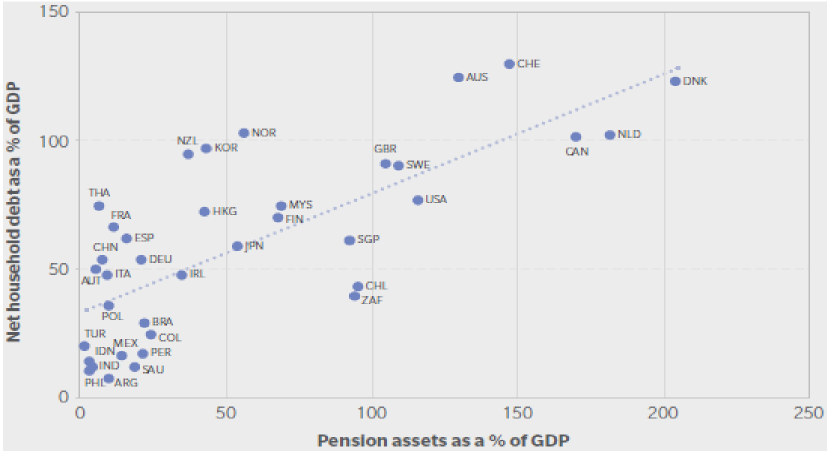
Another way of viewing the problem of the Argentine pension system is the ratio of contributors (11.3 million) to beneficiaries (8.4 million), i.e. there are only 1.4 contributors for each pensioner.

Mercer recommends that Argentina should raise the minimum pension for the poorest; increase family savings and coverage of occupational pension plans with automatic enrolment; establish a contribution to an old age savings fund and improve oversight of the voluntary private system.

The relationship between pension assets and family debt

Graph No.1 shows the relationship between pension assets and the net debt of households, both expressed as a percentage of GDP.

Graph No. 1: Relationship between pension assets and household debt



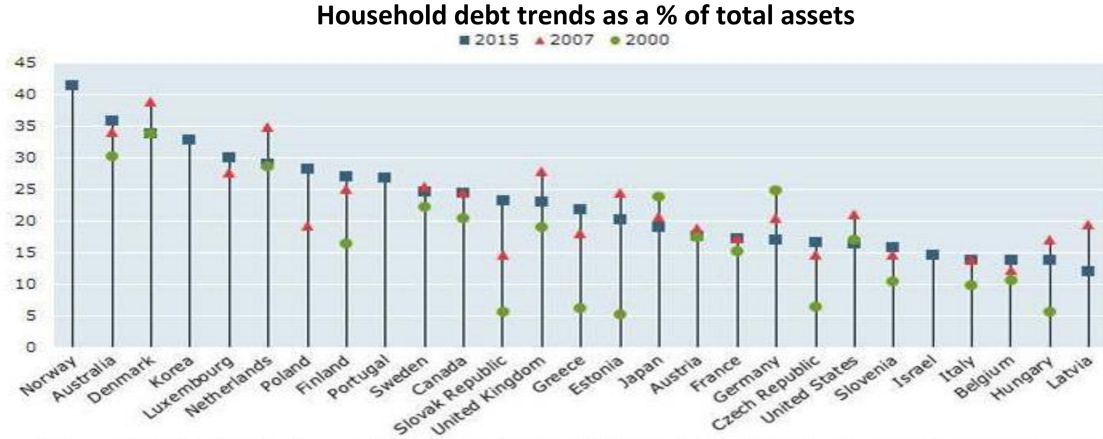
Source: [Melbourne Mercer Global Pension Index, 2019](), page 10.

The correlation between both variables is very high (74.4%) and the slope is 0.466, which suggests that for each additional US$ 1 in pension assets, the net debt of households increases by slightly less than half of that amount.

The logic is that families that feel financially secure because of their pension savings, tend to increase their indebtedness to improve their standard of living.

According to the OECD, (see Graph No.2), Holland and Australia, which have well-developed individually funded pension systems, also have high debt ratios, whereas Belgium, with a predominantly PAYGO system, has a much lower level of indebtedness, possibly because people distrust the stability of benefits, since they can be adjusted by governments.

Graph No. 2
Household debt trends as a % of total assets



Source: https://www.oecd.org/sdd/na/statisticalinsightswhatdoeshouseholddebtsayaboutfinancialresilience.htm

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