Annex A. The Structure of the Chilean Pension System

Before 2022, Chile’s current civilian pension system rested on three pillars:

a. A solidarity pillar provided by the government, targeted to the poorest 60 percent of the population. This pillar includes a base solidarity pension for individuals with no pension savings, a supplement to individuals with very small pension savings, a Survivor pension in case of death, a Child bonus for mothers, and a Young Workers Subsidy.

The supplement (APS, aporte previsional solidario) is calculated according to the following formula:

$$APS = \begin{cases} PBS - \left( \frac{PBS}{PMAS} \times PBase \right) & \text{if } 0 \leq PBase < PMAS \\ 0 & \text{if } PMAS \leq PBase \end{cases}$$

where PBS is the minimum pension (pension básica solidaria), PMAS is the threshold to receive the government supplement, and Pbase is the self-financed pension accruing from the private pension account. Thus, two parameters govern the solidarity pillar: PBS and PMAS. After setting initial levels and after some gradual adjustment, the 2008 law established that PBS and PMAS should remain constant in real terms after 2012, so the whole solidarity pillar is inflation-indexed. In 2019 there were further adjustments to align the parameters with poverty lines. Adjustments were to be gradually implemented over three years (2019–2022).

The projection exercise considers two alternative scenarios for the parameters of the solidarity pillar after 2022: a baseline with inflation indexation and an alternative with real growth of 1.25 percent.

The old-age benefits from the solidarity pillar were replaced in 2022 by a universal guaranteed pension (PGU) targeted to individuals who are not in the top 10 percent of the income distribution. The full amount of the PGU is paid to pensioners whose self-financed pension is below a lower bound (Pinf). Whereas pensioners with a self-financed pension (PBase) above the Pinf but below the upper threshold to receive benefits (Psup) will receive a supplement following the formula:

$$Benefit = \begin{cases} \frac{PGU}{Psup - PBase} & \text{if } PBase \leq Pinf \\ \frac{PGU}{Psup - Pinf} - \frac{PBase}{Psup - Pinf} & \text{if } PGU < PBase < Psup \\ 0 & \text{if } PBase \geq Psup \end{cases}$$
Similar to the PMAS in the PBS/APS system, if a pensioner receives a self-financed pension above the upper threshold $P_{sup}$, they will not receive additional supplement. We do not model the impact on replacement rates or the fiscal cost of the universal guaranteed pension in this paper.

b. The second is a mandatory-contribution pillar in which employees contribute to their individual accounts. The mandatory contribution is 10 percent of gross salary. These mandatory saving accounts are managed by a few Pension Fund Administrators. Affiliates can choose their AFP, of which there are currently seven, and subsequently the fund to invest their pension, between the five available, which provide an expected return with varying degrees of risk. Contributors and pensioners pay a fee set by AFPs, which is a percentage of the contributors’ salary or a percentage of the pensioners’ withdrawal.

c. The third is a voluntary saving pillar, with tax benefits offered to encourage participation.

As in common practice in defined contribution systems, pension fund administrators charge a management fee to its members. This is a piece of the system that has been part of the debate in the past decade. Generally speaking, obtaining a proper international benchmark to assess the feasibility of lowering these fees is challenging. This is due to the fact that pension systems differ, levels of service are heterogeneous, and indirect charges—that are not easily measured—may not be disclosed and accounted for. However, the OECD computes a measure of fees as a percentage of total assets, a technique which aids in cross country comparison. The data, which is displayed in Figure A1, shows that Chile’s fees as a percentage of total assets is 0.8, lower than Mexico at 0.9 percent but above Australia and Israel (countries, like Chile, that have a defined contribution system).
Figure A1. Annual Fees Charged to Members as a Percentage of Total Assets, 2019 or Latest Year Available

1/ Fee for Australia is uncategorized.

Sources: Authors’ calculations based on OECD (2020).