

Description of the Social Security System in Chile

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Article abstract

Avec la réforme des fonds de pension au Chili, laquelle remonte à 1981, le pays s'est vu doté d'un nouveau régime, le AFP (Administradoras de Fondos de Pensiones). C'est un régime administré par le secteur privé contrairement au régime déjà en place, le « Cajas de Previsión » lequel est administré par l'État. Cet article tente de résumer les principales caractéristiques du AFP; par exemple, la nature du fonds de pension, l'adhésion au fonds, les contributions, l'application du fonds à l'âge de la retraite ou en cas de départ volontaire et les organismes qui le régissent.

Description of the Social Security System in Chile

by

Jonathan D.H. Callund¹

Avec la réforme des fonds de pension au Chili, laquelle remonte à 1981, le pays s'est vu doté d'un nouveau régime, le AFP (Administradoras de Fondos de Pensiones). C'est un régime administré par le secteur privé contrairement au régime déjà en place, le "Cajas de Previsión" lequel est administré par l'État.

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Cet article tente de résumer les principales caractéristiques du AFP; par exemple, la nature du fonds de pension, l'adhésion au fonds, les contributions, l'application du fonds à l'âge de la retraite ou en cas de départ volontaire et les organismes qui le régissent.



With the introduction of the social security reform in May 1981, there are now two parallel systems for financing and providing old age, disability and survivors' pensions:

- a) The system of "Cajas de Previsión", or Old System, which is a pay-as-you-go system, administered by the State, in which, for example, the old age pensions are calculated based on the average of the last five years' salary, up to a ceiling of 50 "Sueldos Vitales".
- b) The system of "Administradoras de Fondos de Pensiones", or AFP System, introduced by the law DL 3.500 in November 1980, which is a system of individual

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capitalization, based on a defined contribution as a percentage of the employee's salary and administered by private sector companies, in which the old age pension is calculated on the basis of the total fund accumulated at retirement date.

The main characteristics of the AFP System are as follows:

1. Institutions

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The law DL 3.500 (in future the Law) allowed for the creation of two institutions with completely separate capital bases: on one hand, the Pension Fund and on the other, the Pension Fund Administration company, the AFP.

The Fund is made up of the accumulated monies in the member's *Cuenta Individual*. This is formed by the (obligatory and voluntary contributions) *Cotizaciones Obligatorias and Voluntarias* for old age retirement pensions, plus the return generated by the investment of these funds. The funds belong exclusively to the affiliates.

The AFPs are private sector joint-stock companies, whose sole objective is to administer a Pension Fund and provide the benefits established under the Law. They collect the monthly contributions from the members crediting them to their *Cuenta Individual* and invest the funds according to the terms established by the Law. The benefits they administer include old age, disability and survivors' pensions, according to the conditions established by the Law.

The AFP may charge certain commissions for providing these services, which are paid by the members as a deduction from their *Cuenta Individual*.

However, as will be seen below (1.3), the AFPs also charge an indirect commission via the margin retained from the *Cotización Adicional*.

2 Membership

Membership of the AFP System is automatic for any new employee, who, during the first month of employment, is obliged to join one of the AFPs in the market. Self-employed individuals may join the System voluntarily, paying a contribution based on their declared monthly income.

Members of the Old System, may change to the AFP System at any moment during their working life.

3. *Cotizaciones* (Contributions)

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3.1 *Cotización Obligatoria* (Obligatory Old Age Contributions)

Every employee is obliged to make monthly contributions to their *Cuenta Individual* of 10% of their *Remuneración Imponible* (Remuneration subject to contributions), for the old age retirement pension. *The Remuneración Imponible* is limited to UF60 per month.

3.2 *Cotización Voluntaria* (Voluntary Old Age Contribution)

In addition, each employee may make voluntary contributions to his *Cuenta Individual* of up to around UF48 per months (i.e. UF60, less the amount paid in obligatory social security contributions). Contributions above this are also possible, but are subject to income tax.

3.3 *Cotización Adicional* (Additional Contributions for Disability and Survivors' Pension Insurance)

Each AFP is obliged to take out separate insurance cover to guarantee the financing of disability and survivor pensions. This insurance must be sufficient to cover the difference between the capital required to finance the pensions and the balance remaining in the *Cuenta Individual* at the date of the member's death or disability.

The AFP establishes the amount of the *Cotización Adicional* for its members based on the cost of the insurance

cover and the margin charged by the AFP for administration services it provides. The average *Cotización Adicional* in the market in November, 1992 is 3.05%.

4. Cuenta de Ahorro Voluntario (Voluntary Savings Account)

Each employee may make voluntary contributions to the AFP where he is affiliated together with the contributions mentioned in point 3. These deposits are not treated as social security contributions and are subject to income tax.

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These are deposited in an individual savings account for each member, which is called the "*Cuenta de Ahorro Voluntario*", and which is completely independent of his *Cuenta Individual*.

Members may make up to 4 withdrawals from this account in any calendar year.

The member may at any time transfer part or all of the funds in the *Cuenta de Ahorro Individual* to the *Cuenta Individual*, in order to finance normal or early retirement pensions (See point 6).

5. Bono de Reconocimiento (Recognition Bond)

The "*Cajas de Previsión*", or Old System, are obliged to issue a financial instrument through the Instituto de Normalización Previsional, called a *Bono de Reconocimiento*, or simply '*el Bono*', which represents the periods of contributions registered in the Old System by those employees who change to the AFP System. The amount of the *Bono* is determined based on the *Remuneración Imponible* prior to the date of joining the AFP System, and the number of years of contributions to the Old System.

The *Bono* is nominative, and it is transferred to the member's *Cuenta Individual*. Its value is expressed in UF and it accrues an annual real interest rate of 4%, from the date of the employee's AFP membership, up to the date it is paid.

The *Bono*, its adjustments and the interest accrued becomes payable the day the member reaches the age required to receive an old age pension, or on death or being declared disabled, and it is then paid into the *Cuenta Individual*.

6. Old Age Pensions

Under the AFP System, an affiliate may retire at any age. However, the law considers normal retirement ages of 65 for men, and 60 for women. There are minimum pension requirements for retirement prior to these ages (see point 7). The old age pension is financed with the balance in the *Cuenta Individual* plus the *Bono de Reconocimiento*.

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The ages mentioned above indicate the date as of which the member is able to retire, although there is no obligation to retire at these ages. Further still, if member at retirement age decides to retire, this does not necessarily imply that he must leave his work, as he may continue working and making contributions to the AFP where he is affiliated. The accumulated fund from these contributions may be added to the fund with which the old age pension is financed, in order to increase his pension.

Members who have reached normal retirement ages, even though they have not retired, are not entitled to receive a disability pension.

When a member decides to retire, he may choose from any of the following pension methods:

6.1 Immediate Annuity

The member contracts an annuity with a life insurance company, which is freely chosen by him. This contract obliges the life insurance company to pay a fixed monthly amount, which is expressed in UF, from the moment the contract is signed until the date of the member's death, and also to pay survivor pensions from then on to his beneficiaries.

The Immediate Annuity calculation considers the total accumulated fund in the member's *Cuenta Individual* as a single

lump sum premium, except if he decides to withdraw the *Excedente de Libre Disposición* (see point 7.2).

The fund used to calculate the Immediate Annuity, must be transferred to the life insurance company by the AFP.

The amount of survivor pensions is governed by the following table:

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Beneficiary	Percentage of the retired affiliate pension
1. Wife or disabled husband, with children with no rights to a pension.	60%
2. Wife or disabled husband, with children who have rights to a pension.	50%
3. Children under 18 or 24 years old, if they are students.	15%
4. The mother of natural children with children with no rights to a pension.	36%
5. The mother of natural children with children who have rights to a pension.	30%
6. When there are no other beneficiaries, the affiliate's parents, who are receiving a family allowance.	50%

Survivor pensions are for life, except for those received by non-disabled children, whose pensions are paid until they are 18, or 24 years old, if students.

If two or more persons claim to be the spouse or mother of natural children, at the date of member's death, the corresponding percentage shall be divided by the declared number of spouses or mothers of natural children.

If, at the moment of the member's death, there is no spouse with a right to a pension, the children's temporary pensions shall be increased, distributing the 50% mentioned in point 2 in the previous table, in equal parts.

The decision to take out an Immediate Annuity is irrevocable.

6.2 Temporary Withdrawal with Deferred Annuity

The member contracts with a life insurance company, the payment of a fixed monthly annuity, which is expressed in UF, as of pre-determined future date. This cover includes possible survivor pensions under the same terms and conditions indicated in point 6.1. For this purpose, a necessary portion of the accumulated fund in the *Cuenta Individual* is transferred to the life insurance company in order to finance the Deferred Annuity.

The fund remaining in the AFP is used to finance a Temporary Withdrawal during the period between the retirement date and the date at which the first payment of the Deferred Annuity is due.

The Deferred Annuity may not be less than 50% nor more than 100% of the first monthly payment of the Temporary Withdrawal.

The Temporary Withdrawal is an annual amount expressed in UF, which is paid in 12 equal monthly installments, and is deducted from the balance of the *Cuenta Individual* remaining in the AFP. Its value is determined annually, and is the result of equating the remaining fund in the *Cuenta Individual* with the present value of equal annual payments in advance, during the period remaining until the Deferred Annuity becomes payable.

The discount rate used in calculating the Temporary Withdrawal (*Tasa de Interés para Retiros Programados y Renta Temporal*) is published annually, based on the rate that results from taking the average of the real return of the member's Pension Fund and the interest rate used by the life insurance companies in calculating the AFP Annuities.

The remaining fund in the *Cuenta Individual* at the date of calculating the Temporary Withdrawal corresponds to the fund in the previous year, less pensions paid and plus the investment returns.

A member who is in receipt of a Temporary Withdrawal may at any moment, bring forward the date from which the life insurance company shall start paying the Deferred Annuity.

For this purpose, he may use any of the following mechanisms:

- i) Reduce the amount of the Deferred Annuity, in as far as the new pension is at least 50% greater than the first Temporary Withdrawal received;
- 398 ii) Pay an additional premium deducted from the remaining balance in his *Cuenta Individual* ;
- iii) A combination of i) and ii) above.

The decision to opt for the method of Temporary Withdrawal with Deferred Annuity is irrevocable.

6.3 Programmed Withdrawals

The member maintains the accumulated fund in his *Cuenta Individual* from which he makes monthly withdrawals. The amount is the result of dividing the value of the fund by technical value of the capital needed to pay an annual pension unit to the member and, in case of death, to his surviving beneficiaries, according to the percentages defined in point 6.1.

The interest rate implicit in this calculation is the same as that defined above for the case of the Temporary Withdrawal with Deferred Annuities.

The annual payment that results from this calculation is expressed in UF and it is paid in 12 equal monthly installments. The calculation is repeated each year taking into account the family group structure, the interest rate and the remaining fund balances on each anniversary date. The latter corresponds to the fund in the previous year, less the pensions paid plus the product of its investments.

A member who chooses the Programmed Withdrawal method may, at any moment, change to the method of Immediate Annuity or Temporary Withdrawal with Deferred Annuity.

7. Additional Benefits

7.1 Early Retirement

Members may retire, and choose any of the three methods mentioned previously, before reaching normal retirement age, as long as they comply with the following requirements:

- a) Obtain a pension equal to or greater than 50% of the average Remuneración Imponible received during the last 10 years prior to the month of retirement;
- b) Obtain a pension equal to or greater than 110% of the minimum pension (See point 10.3).

Members who have right to a *Bono* and who, with the accumulated fund in their *Cuenta Individual*, are able to finance the pension until they reach the normal retirement age, may transfer their rights to the *Bono* to the corresponding insurance company, if they opt for the methods of Immediate or Deferred Annuity. Nevertheless, the *Bono* are only redeemable when the member reaches normal retirement age.

The State guarantee indicated in point 10.3 shall not operate during the period of time remaining until the member reaches legal retirement age.

7.2 *Excedente de Libre Disposición* (Free Disposition Surplus)

Members who meet the requirements to retire and whose pension is greater than or equal to 70% of their average *Remuneración Imponible* received during the last 10 years of contributions, and more than 120% of the state minimum old age pension, may withdraw and use freely the fund surplus in excess of the necessary capital to finance the pension.

8. Disability Pensions

Members who do not fulfill the requirements for an old age pension, but who lose at least half of their working capacity as a result of illness or loss of physical or intellectual strength, have a right to a disability pension.

There are two levels of disability cover:

- a) Partial Disability Pension: Equal to 50% of the member's Ingreso Base, payable in the case of a loss of at least 50%, but less than two thirds of working capacity; and
- b) total Disability Pension: Equal to 70% of the member's Ingreso Base, payable in the case of a loss of two thirds or more of working capacity.

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The *Ingreso Base* is equal to the average *Remuneración Imponible* received during the 10 years previous to the date the member is declared disabled, readjusted for price inflation.

In the case where the member ceases to pay regular contributions, e.g. due to unemployment, the cover is extended for a period of 12 months from the date of the last contribution, but considering 50% of the *Ingreso Base* in determining the pension benefit.

The evaluation of disability is carried by specialized Medical Commissions, and involves a revision period of 3 years, i.e. the Commissions 1st Ruling gives rise to a total or partial disability pension which is payable for 36 months, after which time the Commission reviews the evaluation and issues a 2nd Ruling, confirming, modifying or revoking the 1st Ruling. Once declared disabled under the 2nd Ruling, the member's pension is definitive and life-long.

Once a member is declared disabled under the 2nd Ruling, the life insurance company with which the AFP contracted the Disability and Survivor Insurance (See point 3) calculates and transfers the value of the *Aporte Adicional* to the AFP. This *Aporte Adicional* is equal to the difference between:

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- a) *Capital Necesario*, which is equal to the technical capital necessary to finance the member's disability pension and potential survivors' pensions for his beneficiaries, as is indicated in point 6.1; and
 - b) the accumulated fund (including the *Bono de Reconocimiento*) in the *Cuenta Individual*.

The interest rate used in the calculation of the *Aporte Adicional* corresponds to the average market interest rate used by life insurance companies for AFP Annuities.

With the accumulated fund in the *Cuenta individual*, the *Bono* and the *Aporte Adicional*, the disabled member must choose one of the three pension methods mentioned above (see point 6), namely:

- Immediate Annuity
- Temporary Withdrawal with Deferred Annuity
- Programmed Withdrawals

For those members who opt for an AFP Annuity with the same life insurance company that paid the *Aporte Adicional*, this company is obliged to sign the contract and pay a pension no lower than the one considered in calculating the *Aporte Adicional*.

A member who, within the 90 days following declaration of disability, has neither contracted such an annuity with a life insurance company, nor chosen one of the remaining methods, is considered to have opted for an Annuity with the same insurance company that paid the *Aporte Adicional*.

Members who had exercised the early retirement option are not entitled to receive a disability pension, and in this case, the AFP is released from any such obligation or responsibility.

9. Survivors' Pensions

All the members' dependents, indicated in the table of point 6.1, have a right to a survivor's pension.

The life insurance company with which the AFP contracted the Disability and Survivor Insurance (See point 3) must calculate the *Aporte Adicional* necessary to finance the survivors' pensions on the member's death, as in the case of disability pensions.

The amount of these pensions is the result of applying the percentages mentioned in point 6.1 to the *Pensión de Referencia*.

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The *Pensión de Referencia* is calculated as 70% of the *Ingreso Base*, if the member was employed at the date of death, or 50%, if the member had not paid a contribution during the 12 months previous to his death.

The beneficiaries must decide for one of the three pension methods previously mentioned (point 6), based on the accumulated fund in the *Cuenta Individual*, including the *Bono* and the *Aporte Adicional* transferred by the life insurance company.

A decision to opt for the Immediate Annuity or Temporary Withdrawals with Deferred Annuity methods, requires the unanimous agreement of all the beneficiaries. During the period that the option is not taken, the beneficiaries shall receive pension under the Programmed Withdrawals method.

In the case where there are no beneficiaries to survivors' pensions, the remaining balance in the *Cuenta Individual* goes to increase the deceased member's estate.

10. Other Benefits Established by the Law

10.1 Funeral Grant

The person who can prove to have taken charge of the funeral expenses of a deceased member shall have the right to the Funeral Grant, which is equivalent to UF15.

This payment must also be made in the same conditions by the insurance company, which had been paying an Annuity to the deceased member.

10.2 Industrial Injuries and Professional Illnesses

a) *Disability*

Employees who are members of the AFP System, and who receive a disability pension from any legal body providing for the protection against risks of industrial injuries and professional illnesses, are obliged to make the contributions to finance the old age pensions mentioned in point 3 above.

When the member reaches normal retirement age, the disability pension indicated in the previous paragraph ceases, and he shall be entitled to an old age pension, as established in point 6.

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b) *Survival*

Members who die, as a consequence of an industrial injury or professional illness, and those who die while in receipt of a disability pension as a result of an industrial injury or professional illness, shall give rise to survivors' pensions, according to the terms and conditions established in the laws that govern the protection against these risks.

In these cases, the accumulated funds in the *Cuenta Individual* shall go to increase the deceased members estate.

10.3 State Guaranteed Benefits

- a) The State provides for guaranteed minimum old age, disability and survivors' pensions. The survivors' pensions are calculated based on the percentages established in point 6.1.
- b) The State also guarantees the payment of the *Aporte Adicional*, mentioned in point 1.7 and 1.8, Immediate and Deferred Annuities and the Funeral Grant.

The AFP Annuities are 100% guaranteed up to the State minimum pension, and 75% from the remaining amount up to a monthly equivalent of UF45.

11. Taxation

11.1 Social Security Contributions

The part of the *Remuneración Imponible* set aside to finance social security contributions, indicated in point 3, are exempt from income tax.

Contributions made by the employee to his *Cuenta de Ahorro Voluntario* (See point 4) are subject to income tax.

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11.2 Pensions

The monthly pensions paid to the member, according to any of the three possible pension methods, are subject to income tax.

11.3 *Excedentes de Libre Disposición* (Free Balance)

Withdrawals of *Excedentes de Libre Disposición*, according to point 7.2 above, or the *Cuenta de Ahorro Voluntario* (See point 4), are subject to a single lump-sum tax, the rate of which is calculated by applying the same table as used in calculating the *Impuesto Global Complementario*, on 10% the total amount that may be withdrawn. These withdrawals may not be added to other income of the member for declaring or paying any other tax.

The tax above is levied on each and every withdrawal made from the AFP.

11.4 Balance in the *Cuenta Individual* or *Cuenta de Ahorro Voluntaria*

The balance remaining in the *Cuenta Individual* or in the *Cuenta de Ahorro Voluntaria* of a deceased member, which goes to increase his estate, shall be exempt from the tax established by the Estate Duty Law, up to UF4,000.

12. Regulations Governing the AFPs and the Pension Funds

12.1 Minimum Capital

The minimum necessary capital to form an AFP is the equivalent of UF5,000, which increases in relation to the number of members of the AFP:

Number of Members	Capital (UF)
Less than 5,000	5,000
5,000 - 7,499	10,000
7,500 - 9,999	15,000
10,000 or more	20,000

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12.2 Pension Fund Accounting

The AFP is obliged to maintain separate accounts for the Pension Fund.

12.3 Commissions

The AFP is free to establish their administration charges as a commission based on expressly limited and uniform criteria:

- the periodic deposits of contributions;
- the balance of the *Cuenta Individual* on transfer from another AFP; and
- payment of Programmed Withdrawals - the *Cotización Adicional*.

These are the only sources of income for the AFPs.

12.4 Transfers

Any member may transfer the balance of his *Cuenta Individual* to another AFP, after a period of four months, by giving 30 days prior notice to the AFP where his funds are held and to his employer, if applicable.

12.5 Pensions Fund Capital

With the exception of the *Cuenta de Ahorro Voluntaria*, the assets and rights which go to form the Pension Fund capital are not impoundable and may only be set aside to provide the services established by the Law.

In case of AFP bankruptcy, the Pension Fund shall be managed and wound-up by the AFP Superintendency.

12.6 Pension Fund

The value of the Pension Fund is expressed in units of equal amount and characteristics, which are not subject to liens or embargoes.

The unit value is determined daily, based on the market value of the investments, after deducting the AFP commissions.

12.7 Minimum Guaranteed Returns

Each AFP is responsible to generate returns on the Pension Fund under its management. These returns are measured as an average over the preceding 12 months, and may not be lower than the lesser of:

- a) the average returns of all the Pension Funds, during the last 12 months, less two percentage points; and
- b) 50% of the average returns of all Pension Funds during the last 12 months.

The AFP is obliged to set up a Return Fluctuation Reserve (*Reserva de Fluctuación de Rentabilidad*) to guarantee this minimum return. This reserve forms a part of the Pension Fund.

12.8 Encaje

Each AFP must hold assets at least equivalent to 1% of the Fund it manages, less the value of investments in units of other Pension Funds, and investments in instruments issued by the Chilean Treasury (*Tesorería General de la República*) or by the

Central Bank (Banco Central de Chile), which expire within 30 days.

The instruments held as the *Encaje* are not impoundable.

AFPs which do not maintain this *Encaje*, shall be dissolved and wound-up by the respective Minister of Law.

12.9 Pension Fund Investments

The sole objective of the investment of the Pension Fund resources shall be security and to obtain sufficient returns. Any other objective shall be considered against the interest of the Pension Fund.

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The Fund may only be invested in:

- a) instruments issued by the Chilean Treasury or by the Central Bank, and Letters of Credit issued by the Regional and Metropolitan Housing and Town Planning Services;
- b) term deposits and other instruments issued by financial institutions;
- c) instruments guaranteed by financial institutions;
- d) letters of credit issued by financial institutions;
- e) private and public company bonds;
- f) other Pension Fund units; and
- g) equity in opened limited liability companies, previously approved by the Risk Classifying Commission (RCC);
- h) equity in Real Estate Companies, previously approved by the RCC;
- i) units of Investment Funds, previously approved by the RCC;
- j) commercial instruments, such as non-redeemable bills of lading;

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- k) credit notes, bonds and commercial bills issued or guaranteed by foreign States, central banks or foreign banks or financial institutions previously approved by the RCC.

13. Control

13.1 APP Superintendency

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The Law created the AFP Superintendency, which is an independent agent, with legal autonomy and its own assets over an indefinite period, governed by a special organic by-law and depends directly on the Ministry of Labour and Social Security.

The function of this Superintendency is to supervise and control the AFPs. For this purpose, it has developed the following activities:

- a) Authorize the formation of AFPs and keep a record of them;
- b) Control the AFPs operations and the provision of the corresponding services to their members;
- c) Interpret the legislation and set the rules of the System, with obligatory nature to the AFPs and establish general rules for their application;
- d) Control the formation, keeping, operation and application of the Return Fluctuation Reserve and the *Encaje* and investment of those resources set aside for these reserves;
- e) Control the investment of the Pension Funds and the composition of the investment portfolio;
- f) Establish the rules that control the insurance contracts signed to offer services established by the Law, without altering the attributions of the Superintendency of Securities and Insurance (*Superintendencia de Valores y Seguros*), and ensure compliance of these rules and the fulfillment of the obligations that give rise to the contracts;

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- g) Put into effect the winding-up of AFPs and Pension Funds;
 - h) Levy fines and order the dissolution of AFPs in those cases foreseen in this Law;
 - i) Supervise the fulfillment of the rules concerning the State guarantee;
 - j) Act as technical and executive secretary to the Risk Classifying Commission;
 - k) Control the primary and secondary markets in relation to the profit participation of Pension Funds in these markets.

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13.2 Risk Classifying Commission (*Comisión Clasificadora de Riesgos*)

Its function is to approve, modify or reject the projects of classifications of the instruments indicated in letters b), c), d) and e), of point 12.9, in some of the risk categories. Thus, it must approve the equity of open limited liability companies, which may be purchased with Pension Fund resources.

The Risk Classifying Commission is formed by:

- a) the AFP Superintendent;
- b) the Superintendent of Banks and Financial Institutions;
- c) the Superintendent of Securities and Insurance;
- d) three AFPs representatives; and
- e) one representative from the Central Bank.

The risk categories are established based on the probability of non-payment of capital and agreed interest, the characteristics of the instrument, the solvency of the issuer and the liquidity of the instrument in the market.

Glossary

1. *Aporte Adicional*

The value of the capital to be transferred from the life office following a claim under the Disability and Survivor Insurance policy with an AFP, to the member's *Cuenta Individual*.

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The "*Aporte Adicional*" amounts to the *Capital Necesario*, less the balance of the member's *Cuenta Individual* (including the *Bono* and *Complemento*, if due).

2. *Bono de Reconocimiento or Bono*

A financial instrument, issued by the *Cajas de Previsión* of the old system, via the Instituto de Normalización Previsional (INP), in recognition of the contributions made to the old system by the members who have transferred to the AFP system.

The instrument is nominative and accrues an interest of 4% real p.a. as of the moment the individual joined the AFP system. It is payable into the *Cuenta Individual* on disability, death or on reaching retirement age.

3. *Caja de Previsión*

The old social security system of pension provision was a pay-as-you-go system administered by myriad institutions called *Cajas de Previsión*. Each *Caja* had its own structure of contributions, conditions and benefits.

Members of the old system who have not switched do not have a right to benefits from the AFP system. Employees may now not join a *Caja de Previsión*.

4. *Capital Necesario*

The present value of the future pension payable for:

- a) the survivors pensions on the death of an AFP member; or

- b) the disability pensions and potential survivors pensions of a deceased disabled AFP member, considering the obligatory mortality tables and discount rate.

This value is used as the base for calculating the *Aporte Adicional*.

On receipt of the *Aporte Adicional*, the member's *Cuenta Individual* balance will be equal to the *Capital Necesario*, which is the base the member used to decide which of the three pension methods he would like to use.

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5. *Cotización Adicional*

The obligatory social security contribution payable to an AFP to finance the Disability and Survivor Insurance cover. The rate is not fixed and varies from AFP to AFP. The average rate in March 1989 was 3,42% of the *Remuneración Imponible*.

6. *Cotización de Ahorro Voluntario*

Voluntary Contributions made to the *Cuenta de Ahorro Voluntario*.

These contribution are paid from net remuneration, i.e. after social security and income tax deductions.

7. *Cotización Obligatoria*

The obligatory social security contribution payable to an AFP, and deposited in the *Cuenta Individual* to finance the member's old age pension. Since the start of the system, the rate has been 10% of *Remuneración Imponible*.

8. *Cotización Voluntaria*

Voluntary contributions paid by the member into his *Cuenta Individual* to supplement his old age pension provision.

Contributions up to around UF48 per month (UF60, less the obligatory health and AFP contributions - average 20,05%) are not subject to income tax.

These contribution and interest earned there on are not considered in the offset from the *Capital Necesario* in the case of in service death or disability.

9. Cuenta de Capitalización Individual o Cuenta Individual

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10. Cuenta de Ahorro Voluntaria

The individual members voluntary savings account. This is completely independent of the *Cuenta Individual* and is used to hold the member's *Cotizaciones de Ahorro Voluntario*.

Like the *Cuenta Individual*, this account is also maintained in AFP units. However, it differs from the above, in that the member may make up to four withdrawals from the account in any calendar year, subject to payment of a single lump-sum tax on each withdrawal.

11. Encaje

This is the obligatory Cash Reserve the AFP is obliged to form from its own resources. The reserve must at all times be equal to at least 1% of the total value of the Pensions Funds under its management.

The maintenance and investment of the reserve is closely monitored by the SAFP.

12. Ingreso Base

The terms used in calculating the *Capital Necesario*, to describe the average *Remuneración Imponible* received over the 10 years (or since the start of the AFP system) prior to a members in service death or disability.

13. Instituto de Normalización Previsional (INP)

The State organization established to coordinate the administration and winding-up of all the old system *Cajas de Previsión*.

The INP is responsible for supervising and issuing the *Bono de Reconocimiento*.

14. *Pensión de Referencia*

The term used in calculating the *Capital Necesario* to define the pension rights and it is determined to be:

- a) 70% of the *Ingreso Base*, if the member paid a contribution in the month in which the claim for a disability or survivor pension was presented; or
- b) 50% of the *Ingreso Base*, if the member had not paid a contribution within 12 months of the time the claim for a disability or survivor pension was presented.

15. *Remuneración Imponible*

The workers gross monthly remuneration, up to social security ceiling of 60UF per month.

This forms the basis for the *Cotizaciones Obligatorias y Adicionales* and the *Ingreso Base*.

16. *Tasa de Interés (Actualización) (Discount Rate)*

There are four different technical rates used in the calculation of the benefits payable under the AFP system:

16.1 AFP Annuities

The technical rate used by the life offices in determining the benefits to be offered under an Immediate or Deferred AFP Annuity policy.

This rate is free and subject to market conditions. At September 1992 the average market rate was 5.25% real p.a.

16.2 Mathematical Reserves

The technical rate determined according to the matching regulations, set out in SVS Circular No. 1041 (31st of October, 1991) for calculating the mathematical reserves to be held for all AFP Annuity policies.

This sets down a minimum technical rate of 3% real p.a. for 20% of the technical reserves. The remaining 80% of the reserves are valued in accordance with the matching of the flow of asset and liability payments.

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16.3 *Aporte Adicional*

The technical rate used in calculating the *Capital Necesario* and hence the amount the life offices *Aporte Adicional* to the members' *Cuenta Individual*, on in-service death or disability.

The rate is equal to the average market rate for AFP Annuities in each quarter of the year.

The rate is published every quarter and monitored by the Banco Central de Chile.

16.4 Programmed and Temporary Withdrawals

The rate used by the AFPs to calculate the value of the members programmed and Temporary withdrawals, to be deducted from the *Cuenta Individual*.

The rate is determined annually by the AFP Superintendency, as a weighted average of the following market rates;

- a) 20% of the respective AFPs average rate of return over the previous five calendar years; and
- b) 80% of the average market rate for AFP Annuities (including all types of annuity) over the previous calendar year.

The rates a) and b) are calculated annually and monitored by the *Banco Central de Chile*.

17. *SuperIntendencia de Valores y Seguros (SVS)*

The Superintendency of Securities and Insurance Companies is the State agent responsible for overseeing public and private company returns, the stock exchange and the insurance market.

18. *SuperIntendencia de AFP (SAFP)*

The AFP Superintendency is the State agent responsible for overseeing the AFP system.

19. *UF (Unidad de Fomento)*

A legally recognized and commonly used indexed unit of account, directly linked to movements in domestic prices, one month in arrears. The “rates of exchange” (UF to Ch\$ pesos) are published one month in advance by the Central Bank.