Santiago, 28rd November 2012

Mr. Nikola Abadjiev
President
BAPSC
BULGARIA

Dear Nikola:

In view of the doubts and comments that have been appearing in the Bulgarian press, implying that the Chilean system has been a failure, I want to highlight certain studies carried out by specialists on the subject. These confirm the good performance of the Chilean individually-funded system, reformed in the year 1980, which has now been in force for 32 years. I also want to send you figures with the results produced by that system.

Among these reports is the one prepared by the Presidential Advisory Council for the Reform of the Chilean Pension System, chaired by Mario Marcel, former director of Budgets in the Government of former President Ricardo Lagos and member of the Socialist Party. In its final report[1], the "Marcel Commission", as this Council was known, made up of specialists from all parts of the country's political spectrum, concluded categorically that[2]:

- The individually-funded scheme created by the reform in 1981 is not in crisis; it operates as forecasted; the contributions of employed workers are paid regularly; the AFPs comply with their legal obligations; members have their funds in safe keeping; in only two years have the investments produced negative yields; and in 25 years of the system's operation there have been no frauds and no AFP has gone bankrupt.
- The individually-funded scheme has not failed as a funding mechanism. For workers in stable employment who contribute regularly throughout their working lives, the funds accumulated allow pensions to be funded that are similar to their income while working.
- The individually-funded scheme has also had positive effects on the growth and development of the country's capital market. These effects are reflected not only in

[1] Presidential Advisory Council for Pension Reform. The right to a Dignified Old Age. Working towards a Social Contract with Social Security in Chile. Volumes I and II. Year 2006

[2] Presidential Advisory Council for Pension Reform. The right to a Dignified Old Age. Working towards a Social Contract with Social Security in Chile. Executive Summary. Year 2006, Page 5.

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macro-economic indicators, but also in situations much closer to individual situations, such as the cost of mortgage loans, consumer loans and loans for small businesses.

The report of the "Marcel Commission" cleared up a lot of doubts and questionings of the AFP system that had arisen prior to the presidential and parliamentary election campaigns of December 2005. The basic error behind these criticisms was that people confused the AFPs, which are the second contributory pillar of the system, with the Chilean pension system as a whole. It was unjustly criticized and no credit was given for the benefits and strengths that the system had brought to the economy, to employment and especially to workers who, having contributed regularly during their working lives, will now be able to fund pensions similar to their income while working, thanks to the reform.

We can mention several strengths in the Chilean Pension System, and among them we would highlight: the accumulation of funds (over US$157 thousand million[3]) which, invested in the sectors of greatest economic potential, have contributed decisively to the country's economic growth. According to the study carried out by Vittorio Corbo and Klaus Schmidt-Hebbel[4], 11% of the economic growth of the Gross Domestic Product (GDP) in the years 1981-2001 is attributable to the pension reform; and that impact is also reflected in the growth of the Chilean capital market and the corporate governance of businesses; the impact on budget deficits[5]; the change in members' conduct - people are showing more concern about their savings and in some cases, without considering the legal obligation, have decided to build up their pension by voluntary contributions over and above the legal amount.

However, the "Marcel Commission" report also states that, given the number of years of the private pension system (32 years at present) and due to the trends that are appearing in the Chilean labour market, the pension system needs to be revised. In its report, the Commission states:

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[3] Figure as of October 2012. Source www.spensiones.cl

[4] Corbo, V. and K. Schmidt-Hebbel (2003) "Macroeconomic Effects of the Pension Reform in Chile" in Pension System Reform: Results and Challenges (FIAP), published by CIEDESS.

[5] The study by Professor Rodrigo Cerda (Catholic University) shows that if there had been no pension reform, the annual fiscal deficit, simply in terms of the pay-as-you-go contributory pension system, would amount to 8% of GDP, there would be 550 thousand fewer jobs in 2005 and a GDP per capita 10% lower than at present. Pensions in Chile: What would have happened without the 1981 Reform? Discussion Paper, Institute of Economics, PUC, 2006.

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- A pension system does not have to be immersed in a crisis in order to need reforming. The fact that it is being exposed to greater demands from society is reason enough.
- The available information shows that a considerable percentage of the country's workers have not managed to contribute with the constancy required by the new system and the yield on their contributions, despite so far having surpassed initial expectations, has not been sufficient to correct this situation. For that reason, if things remain as they are, a percentage of members will obtain pensions lower than their wages.

The Marcel Commission carried out an exhaustive diagnosis of the Chilean Pension System, identifying its strengths, weaknesses and future challenges, and drew up a series of proposals for improvement (70 reform proposals) which constituted the basis of Draft Law Nº 20,255, which was published in the Official Gazette on 17th March 2008 and began to come into operation as from July that year, gradually providing the first benefits.

In the Marcel Commission report, it was concluded that there was no need for a total reform; but it was rather a question of putting together a set of reforms on various aspects of the functioning and organization of the pension system, with the ability to enlarge and rebalance the structure of rights and obligations and institutional responsibilities. The reform, therefore, had to be capable of strengthening the structure that supports the rights and obligations of the pension system. Specifically, instead of giving priority to a particular financial mechanism, it had to achieve a complementary balance. This meant setting up an integrated solidarity pillar, strengthening the contributory pillar, developing the voluntary pillar and ensuring that they were all consistent with one another.

The great merit of this 2008 Reform has been the strengthening of the pension system by the clear definition of three pillars: a first solidarity pillar, a contributory pillar and a voluntary pillar. The Reform guarantees a pension for all Chileans, whether or not they have contributed towards financing it, recognizing in that way the contribution made by each individual to society, whether through paid work or not. It also encourages individual funding and rewards those who save. So a system has been set up that protects the most needy but encourages saving.

I. First Pillar

With the 2008 Reform, the System of Solidarity Pensions (SPS) came into being, providing basic solidarity old-age and disability pensions for people who have not accumulated savings for their retirement and solidarity contributions to those who have managed to save in a individual funding account, but their savings are insufficient. The benefits of the SPS, which began to be dispensed as from 1st July 2008, are: the PBS (Basic Solidarity Pension)[6] and the APS (Solidarity Pension Contribution)[7].

It is worth mentioning that this First Pillar currently covers the poorest 60% of the population and it was possible to boost it after the 2008 Reform, thanks to the fiscal surpluses generated by the AFP system. If the AFPs had not solved the pension problem for the vast majority of the country, there would have been no resources to create this first pillar.

Results

The beneficiaries of the Solidarity Pillar (PBS) and (APS) in the first six months of 2012 totalled 1,104,673 individuals as a monthly average (an increase of 4.2% compared with the previous half-year period). As regards the fiscal expenditure associated with these benefits, during the first half of 2012 this amounted to $443,006 million (Approx. USD 869 million).With regard to the Solidarity Pillar's coverage, in June 2012, of the total number of

[6] The Basic Solidarity Pension (PBS) is a benefit provided by the State to men and women aged 65 who are not entitled to a pension under any social security system; and who have been resident in Chile for at least 20 years. The amount of the PBS is readjusted in July each year according to the variation in the Consumer Price Index (CPI) of the last 12 months, counting from the latest readjustment. The PBS (for old-age and disability) was $60,000 per month (USD 119 approx.) as from July 2008 and $75,000 (USD 142 approx.) as from July 2009. Since 1st July 2011, the PBS has been in steady state, covering 60% of the least wealthy population. As from 1st July 2012, the amount of the PBS (old-age and disability) has had a value of $80,528 per month (USD 166 approx.)

[7] The Solidarity Pension Contribution (APS) is a monthly cash payment made by the State which boosts the pensions (old-age, survivorship and disability) of those people who paid contributions into a pension scheme and receive one or more pensions from the AFPs, insurance companies or IPS (Social Pension Institute), provided that the sum of these is less than the Maximum Pension with Solidarity Contribution (PMAS). As from 1st July 2008, the PMAS was $70,000 (USD 132 approx.) The PMAS has been increasing gradually. Since 1st July 2011 the APS benefit has been at steady state, covering 60% of the least wealthy population. From that same date, the value of the PMAs amounted to $255,000 (USD 526 approx.).

pensioners in the AFP system, the former Pension "Cajas" and the Solidarity Pillar, 33.7% and 27.9% receive the PBS and APS benefits, respectively[8].

II. Second Pillar

With the 2008 Reform, contribution incentives have been given to sectors that have shown lower contribution density, such as young people (the hiring subsidy, with benefit for the employer and subsidy on the contribution, with a payment into the young worker's individual funding account, financed by the State[9]), the self-employed[10], and women[11] (a grant for every live birth for women enrolled in the AFP system). Investment regulations have been improved (some that we can highlight are the more flexible investment limit structure and the increase in the limit on investment abroad, which can now reach up to 80% of the funds). Some of these benefits began to applied as from 1st October 2008 and others as from 1st July 2009.

[8] Source: Informe de Seguimiento de la Reforma Previsional, January-June 2012, Superintendence of Pensions – Chile.

[9] The hiring subsidy is a benefit paid to employers by the State since October 2008 for hiring workers between 18 and 35 years of age. It is equivalent to 50% of the pension contribution laid down in section 1 of article 17 of Decree Law Nº 3,500 in 1980, calculated on a minimum wage for each worker hired whose wage is equal to or less than 1.5 times the monthly minimum wage ($289,500, approx. USD 602). In the case of the contribution subsidy, young people have begun since 1st July 2011 to receive a state subsidy of the same amount as the hiring subsidy (payments began to be made as from September 2011, including the period for implementing this incentive bonus), this to be paid directly into his/her individual funding account.

[10] All self-employed workers who issue fee receipts, receive receipts for provision of services from third parties or belong to an association of professionals will be obliged to pay contributions as from the years 2012. Between the years 2012 and 2014, while the contribution system for self-employed workers is being fully implemented, workers may decide not to save during this period if they express their decision in writing to the Inland Revenue Service (SII). As from the year 2015, contributions from self-employed workers who charge fees will be compulsory.

[11] The State gives a grant to women for each live birth. Each grant is equivalent to 10% of 18 minimum monthly taxable incomes at the time of the child's birth. In July 2012 this is approximately $347,000 (USD 720 approx.). These amounts will be readjusted from the date of birth of the child until the mother reaches 65 years of age. The grant will be readjusted by the yield obtained by Fund C in the period.

Results

As regards the contribution subsidy (contribution to the young worker's individual funding account), 153,826 subsidies have been paid during the first half of 2012, originated by 56,428 workers, of whom 54.6% are women. The average monthly amount of subsidy for a single period is $6,742 (approx. USD 14) for women and $6,896 (approx. USD14.3) for men. The total amount paid for this benefit in the first half of 2012 corresponds to $1,044 million (approx. USD2.17 million).

As regards the hiring subsidy, (subsidy to the employer) a total of 10,197 subsidies were paid in the first half of 2012 (96% more than those paid in the previous half-year), originated by 5,293 workers of whom 46.9% are women (these benefits have been given to 133 employers).

As regards the child grant for women, for each live birth, this has benefited 212,448 women since its implementation (July 2009) until June 2012. During the first half of 2012 this benefit has meant an increase of $9,281 (approx.USD19.3) and $19,947 (approx.USD41.5) for PBS and survivorship pensioners, respectively, as a monthly average per beneficiary and $1,190,398 (approx. USD 2,475) in a single payment to those women who transferred this amount to their respective individual funding accounts.

As far as the investment performance of the pension funds is concerned, it is possible to state that in spite of the crises, all members who have been in the multi-funds for a decade have obtained positive yields on their savings, both those who chose the more risky funds (A and B) and those who opted for the more conservative ones (C, D and E). Those who have remained in Fund A all this time (as of June 2012) have obtained a nominal average annual yield of 10.1%; those in Fund B, 9.1% per year; those in Fund C, 8.6%; those in D, 8.1% and those in E, 7.4%. Meanwhile, the accumulated yield in that same period ranges from 155% for Fund A to 100% for Fund E (see Table Nº 1)[12].

Contrary to all those who enjoy exaggerating transitory negative periods, it is demonstrated indisputably that the balance of the funds' yield over a long time axis is positive.

As may be seen in Table Nº 1, the most conservative funds, where people approaching retirement ought to be, have obtained favourable yields. What is more, a glance at the complex situation of the year 2011 reveals that the most conservative funds, D and E, marked a difference compared with the more risky funds, obtaining positive results of 4.0% and 8.4% respectively.

[12] Source: Multi-funds Bulletin Nº 36 – July 2012, Chilean AFP Association.

Table Nº 1

Nominal Annual Yield of the Multi-funds

Year	A	B	C	D	E
2003	28.2	17.2	11.7	10.1	4.4
2004	15.5	12.8	11.4	9.3	7.9
2005	15.2	11.4	8.6	6.7	4.7
2006	24.7	21.2	18.1	13.7	9.6
2007	17.8	15.0	12.4	10.5	9.0
2008	-34.7	-23.6	-11.4	-1.5	8.3
2009	40.1	30.2	19.6	12.6	5.8
2010	14.4	14.1	12.0	9.7	9.3
2011	-7.7	-3.9	0.0	4.0	8.4
Jan.-Jun. 2012	2.3	2.7	3.4	3.4	3.5
Accumulated	155.0	134.1	123.0	113.7	100.3
Annual Average	10.1	9.1	8.6	8.1	7.4

Real Annual Yield of the Multi-funds

Year	A	B	C	D	E
2003	26.9	16.0	10.5	8.9	3.3
2004	12.9	10.3	8.9	6.8	5.4
2005	10.7	7.3	4.6	2.8	0.9
2006	22.3	18.8	15.8	11.5	7.4
2007	10.1	7.5	5.0	3.3	1.9
2008	-40.3	-30.1	-18.9	-9.9	-0.9
2009	43.5	33.4	22.5	15.3	8.3

2010	**11.6**	**11.4**	**9.3**	**7.1**	**6.7**
2011	**-11.1**	**-7.5**	**-3.8**	**0.1**	**4.3**
Jan.-Jun. 2012	**0.8**	**1.2**	**1.8**	**1.8**	**2.0**
Accumulated	**85.7**	**70.8**	**62.3**	**55.6**	**46.0**
Annual Average	**6.5**	**5.6**	**5.1**	**4.6**	**4.0**

III. Third Pillar

With the 2008 Reform, incentives for Voluntary Pension Saving (APV) were provided. The reform included a new tax scheme, letter A, art. 20L, coexisting with the old one, letter B, art. 20L. The letter A scheme says that the worker does not have tax exemption when making a Voluntary Pension Saving (APV) deposit, though this is included in the letter B scheme. This modification seeks to encourage saving among lower-income members, accompanying individual saving with an incentive from the State. The reform also gives new incentives for voluntary saving through Collective Voluntary Pension Saving (APVC)[13]. This option came into operation as from 1st October 2008.

Results

As regards Voluntary Pension Saving (APV), in June 2012 the number of people with voluntary contribution accounts corresponded to 583,595, representing 6.4% of those enrolled in the system at that date. On the other hand, the total balance of the voluntary contribution accounts is $1,989,846 million (approx. USD 3,904 million) which represent 2.71% of all the pension funds' assets[14].

A considerable increase may be observed in the number of average monthly deposits on the part of members who have chosen the new tax scheme, Letter A, art. 20L in the first half of 2012 compared with the second half of 2011 (65.8%), while in the case of members who opted for the old scheme, Letter B, art. 20L, there was a fall of 10% compared with the

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[13] Collective Voluntary Pension Saving (APVC) is a mechanism through which the savings made by workers will be matched by their respective employers, with tax benefits.

[14] Source: Informe de Seguimiento de la Reforma Previsional, January-June 2012, Superintendence of Pensions – Chile.

second half of 2011. As a monthly average, in the first half of 2012 the number of deposits under the new scheme amounted to 53,521, while in the old tax scheme it was 82,570.

As regards Collective Voluntary Pension Saving (APVC), there were 47 valid contracts in existence in June 2012, with a total of 2,035 accounts, managed by the AFPs (21%) and the Mutual Fund Managers (79%). The total balance of these savings corresponds to $637,020 thousand (approx. USD 1,325 thousand), representing an increase of 41% compared with December 2011. In relation to the composition of the balance, 28% was contributed by the employer and the remaining 72% by the worker. In this latter case, 41% of the resources deposited by the workers were recorded under the new scheme (letter A, art. 20L) and 59% under the old scheme (letter B, art.20L).

These 3 pillars must be capable of complementing one another and combining to contribute towards granting dignity of life to the elderly in their old age.

I hope that this information will make it possible to correct inaccurate statements that may appear in the media.

I will be happy to help you with any queries or needs related with this subject.

With warmest regards,

Guillermo Arthur
President

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