

DOCUMENT OF THE INTER-AMERICAN DEVELOPMENT BANK

## **CHILE**

### **STRENGTHENING OF PENSION SYSTEM MANAGEMENT AND INFORMATION**

**(CH-L1024)**

### **LOAN PROPOSAL**

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Annex III	Procurement Plan	<a href="http://opsws3.reg.iadb.org/idbdocswebservices/getDocument.aspx?DOCNUM=993407">http://opsws3.reg.iadb.org/idbdocswebservices/getDocument.aspx?DOCNUM=993407</a>
Annex IV	Currency	<a href="http://opsws3.reg.iadb.org/idbdocswebservices/getDocument.aspx?DOCNUM=1030058">http://opsws3.reg.iadb.org/idbdocswebservices/getDocument.aspx?DOCNUM=1030058</a>

**INFORMATION AVAILABLE IN THE RE1/DIV FILES**

**PREPARATION:**

Report of the Institutional Capacity Assessment System (ICAS)  
Findings of the program risk assessment

## ABBREVIATIONS

AFP	Administradoras de fondos de pensión [pension fund managers]
AWP	Annual Work Plan
CGR	Contraloría General de la República [Office of the Comptroller General of the Republic]
DIPRES	Budget Office
ICAS	Institutional Capacity Assessment System
ILO	International Labor Organization
INP	Instituto de Normalización Previsional [Pension Standardization Institute]
IPS	Social Security Institute
LCF	Local Currency Facility
MIDEPLAN	Ministry of Planning
MINDHA	Ministry of Finance
MINTRAB	Ministry of Labor and Social Security
PASIS	Pensiones asistenciales [welfare-based pensions]
PBS	Pensión básica solidaria [basic welfare-based pension]
PCR	Project completion report
PEP	Program execution plan
PEU	Program execution unit
PMGE	Pensión Mínima Garantizada por el Estado [State-guaranteed Minimum Pension]
PROPEF	Project Preparation and Execution Facility
SAFP	Superintendencia de Administradoras de Fondos de Pensión [Superintendency of Pension Fund Managers]
SPS	Sistema de Pensiones Solidarias [Welfare-based Pension System]
SSPS	Social Security Division
SUSESO	Superintendencia de Seguridad Social [Superintendency of Social Security]

## PROGRAM SUMMARY

### CHILE STRENGTHENING OF PENSION SYSTEM MANAGEMENT AND INFORMATION (CH-L1024)

Financial Terms and Conditions <sup>1</sup>			
Borrower: Republic of Chile		Amortization period:	10 years
		Grace period:	3 years
Executing agency: Ministry of Labor and Social Security (MINTRAB)		Disbursement period:	3 years
		Interest rate:	Adjustable
Source	Amount (US\$)	Inspection and supervision fee:	0%
IDB (Ordinary Capital):	17.5 million	Credit fee:	0.25% on undisbursed amounts
Local:	17.5 million	Currency:	U.S. dollars from the Single Currency Facility
Total:	35 million	Conversion to Chilean pesos:	Local Currency Facility
Program at a Glance			
<p><b>Program objective:</b> The purpose of the program is <b>consistent and coordinated management and better performance of the civil pension system with more efficient benefit administration and greater user participation and confidence</b>. The following specific objectives stem from that purpose: (i) strengthen the pension system's policy-making, supervision, coordination, and evaluation functions in order to improve operational consistency and coordination; (ii) improve the administration of noncontributory benefits and the benefits of the previous system,<sup>1</sup> making pension information systems more integrated, efficient, and transparent and enhancing the performance of customer service mechanisms; and (iii) strengthen user participation in the pension system and promote activities to develop a greater sense of responsibility among users of the pension system and among citizens as a whole.</p> <p><b>Special contractual conditions:</b> As a condition precedent to the first disbursement of the loan proceeds, the executing agency will provide evidence, to the Bank's satisfaction, that: (i) the program execution unit (PEU) is up and running and has been allocated the resources and necessary staff to operate; (ii) recommendations arising from the Bank's institutional capacity assessment of MINTRAB's Social Security Division (SSPS) have been implemented; and (iii) the program execution plan (PEP) has entered into force.</p> <p><b>Exceptions to Bank policies:</b> With regard to the policy governing the Local Currency Facility (LCF) (document GN-2365-2 of 4 November 2005): (i) the clause on interruption of the Bank's access to local currency will not apply (see paragraph 3.22 and Annex IV, section 3). To expand funding opportunities for the borrower, the conversion of program disbursements into local currency will be subject to two financing conditions in addition to those established for the LCF: (i) flexible amortization profiles for disbursements and balances owed in local currency; and (ii) pricing based on the Bank's actual funding costs in the event that it secures funding through bond issues (see paragraph 3.22 and Annex IV, section 3).</p>			

<sup>1</sup> Generic references in this document to the "previous" or "old" system refer to pension regimes of the former social insurance funds and the Social Security Service, which are currently administered by the Pension Standardization Institute (INP).

Project consistent with country strategy:	Yes [ X ]	No [ ]			
Project qualifies as:	SEQ [Yes]	PTI [ No ]	Sector [ ]	Geographic [ ]	Headcount [ ]
Verified by CESI on: 9 February 2007					
Environmental and social review:					
Procurements will be made in accordance with Bank policies (see paragraphs 3.5 and 3.6).					

<sup>1</sup> The interest rate, credit fee, and inspection and supervision fee mentioned in this document are established pursuant to document FN-568-3 Rev. and may be changed by the Board of Executive Directors, taking into account the available background information, as well as the respective Finance Department recommendations. In no case will the credit fee exceed 0.75%, or the inspection and supervision fee exceed 1% of the loan amount.\*

\* With regard to the inspection and supervision fee, in no case will the charge exceed, in a given six-month period, the amount that would result from applying 1% to the loan amount divided by the number of six-month periods included in the original disbursement period.

## I. FRAME OF REFERENCE

### A. Chile's pension system

- 1.1 In the 1980s, Chile undertook one of the deepest structural reforms of a pension system. For the first time, a public defined benefit system was replaced by an individually funded system with individual defined contributions and private management of accumulated funds. Twenty-five years after the reform, the individually funded system is working as could be expected. Nonetheless, it has still not reached full maturity, since most current pensioners (65% of the total) are workers retired under the previous pension funds. Of the retirees covered by the current individually funded system (35%), the vast majority spent a significant portion of their contributory years paying into the previous pay-as-you-go system. It will take another estimated 20 years for the new system to reach sufficient maturity to yield results for the majority of retirees.
- 1.2 The civil pension system resulting from the reform described above has three components, which are not fully coordinated:
  - a. Individually funded defined-contribution system, managed by pension fund managers (AFPs), which are overseen by the Superintendency of Pension Fund Managers (SAFP). This system includes a state-guaranteed minimum pension (PMGE) for affiliates of the AFPs who have accumulated 240 months of contributions but whose total savings are insufficient for a pension equal to or greater than the minimum pension.
  - b. Defined-benefit contributory system (pay-as-you-go), which is being phased out; it is managed by the Pension Standardization Institute (INP) and overseen by the Superintendency of Social Security (SUSESO).
  - c. Noncontributory welfare-based pension system (PASIS), managed by the public sector (municipios, local governments, INP) and supervised by SUSESO.

**Table I-1: Assets and liabilities of Chile's pension system (2006)**

	Public system			Private system
	PASIS	INP	Armed Forces and Carabineros <sup>a</sup>	AFP
Assets		152,458		3,955,992
Liabilities	439,682	982,019	150,989 <sup>b</sup>	382,006
				(PMGE) 69,645

Source: Arenas de Mesa, A., "El sistema de pensiones en Chile"[The Pension System in Chile], *El sistema de Pensiones en Chile en el contexto mundial y de América Latina: Evaluación y desafíos* [The Pension System in Chile in the global and Latin American context]. International Labor Organization, 2004.

<sup>a</sup> Uniformed national police.

<sup>b</sup> In 2005.

- 1.3 The 1981 reform made it possible to provide better pensions than under the pay-as-you-go system, at a lower cost for workers and employers, and without fiscal



imbalances. The assumptions of this arrangement included that: (i) individual ownership of pension funds would be perceived by workers as an important contribution incentive; (ii) workers would contribute consistently throughout their working life and for all their earnings; (iii) the pension funds would earn significant, low-risk net returns; (iv) female home owners would participate in the family income; and (v) by contributing for at least 240 months, low-income workers would qualify for the State-guaranteed minimum pension. This scenario was based on the assumption of a work force composed primarily of male heads of household with indefinite-term jobs who contribute consistently throughout their working lives. However, as a result of major sociodemographic changes<sup>2</sup> and poor participant behavior, a large number of workers have not contributed with the constancy required by the new system, and their contributions have not yielded high enough returns to remedy the situation. Table I-2 summarizes the principal deviations from the basic assumptions of the 1980s reform, illustrating the need for significant changes in the pension system. The two most important factors are the lower contribution density and the replacement ratio.

**Table I-2**  
**Performance assumptions of the 1981 pension reform:**  
**Projected targets and targets actually met**

	Projected	Actual
Coverage	Above 65%	55%
Years of working life	45	40
Contribution density <sup>3</sup>	85%	52%
Return on pension funds	5%	4.5% to 6.5%
Replacement ratio <sup>4</sup>	70% to 80%	44%

Source: Presidential Advisory Council on Pension Reform, 2006

## **B. Main problems and challenges faced by Chile's pension system**

- 1.4 In the first place, these deviations mean that a sizeable portion of workers will receive pensions that are significantly lower than their earnings, and it is unlikely that this situation can be remedied with family transfers or State subsidies. It is estimated that in 20 years only about half the elderly population will have pensions that are higher than the minimum, less than 5% will be eligible for State-guaranteed minimum pensions, and the rest will receive a pension lower than the minimum, a welfare-based pension, a survivors' pension, or no pension at all. This will mean

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<sup>2</sup> These include increased life expectancy, later entry and more women entering the job market, high job turnover (with the consequent decline in the importance of indefinite-term relative to fixed-term, seasonal and part-time work), and reduced importance of the extended family.

<sup>3</sup> Defined as the proportion of an individual's working life during which he or she contributes to the pension system, and reflecting the continuity of such contributions.

<sup>4</sup> Defined as the proportion of the value of the last wage replaced by the pension received.

nearly one million people with pensions below the minimum in 2025. Those at greatest risk of finding themselves in this situation are low-income workers, temporary workers, the self-employed, and a large share of women. This gives rise to the **challenge of expanding coverage of the pension system, extending social security protection to all citizens, and minimizing the risk of old-age poverty**. Among other things, this will mean increasing contribution density and making the contributory and noncontributory elements of the system more integrated and complementary.

- 1.5 Secondly, over time the system has revealed sharp inequities and inefficiencies caused by lack of coordination of the different benefits provided under different pension regimes, and by institutional dispersion. This reflects the absence of an overall vision of social security, as a result of which the system's contributory and noncontributory benefits were designed for separate and unconnected regimes. It also results from a highly dispersed institutional framework and overlapping jurisdictions in policy-making, system supervision, and benefit administration. Policy-making is the responsibility of the Ministry of Labor and Social Security (MINTRAB), acting through its Social Security Division (SSPS), where serious institutional shortcomings weaken leadership of the pension system. Benefit supervision and administration are encumbered by institutional dispersion due to the large number of participating institutions (SAFP, SUSESO, INP, MIDEPLAN, etc.), while leadership problems hinder effective coordination. Finally, the system lacks a central information unit for regular monitoring of strategic indicators so that decisions can be made early, before problems become difficult to resolve. This creates the **challenge of streamlining, aligning, and integrating the institutional framework of the pension system for consistent and coordinated management and operation**.
- 1.6 Thirdly, there is a strong perception of "vulnerability" to future risk and a limited participation of the population in the current pension system. The data available show that 53% of users regard the current pension system as poor or very poor.<sup>5</sup> The low level of affiliation, stemming from insufficient information on the system's complex workings and mistrust of the major role played by private entities (AFPs) in implementing a public policy, have weakened users' commitment to meeting their obligations. The system thus faces the **challenge of building citizen confidence in the public and private institutions comprising the pension system**, which demonstrates the need for an institutional framework that fosters citizen participation and provides better information services.

### C. Toward a new reform

- 1.7 A key element of the current administration's agenda is to develop a social protection system that creates opportunities and limits risk for those who cannot

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<sup>5</sup> MORI survey: "Estudio para el Consejo de Reforma del Sistema de Pensiones. Cruces según sexo, edad y educación" [Study for the Pension System Reform Council: Cross-referencing by Sex, Age, and Education], 2006.

protect themselves. To this end, the government has undertaken to reform the civil pension system by tackling a broad array of challenges, including those described above (see paragraphs 2.4 to 2.6). It created a Presidential Advisory Council on Pension Reform in March 2006 to review pension system performance and conduct a broad process of public hearings. It produced a full diagnostic assessment and proposed reforms for the system.<sup>6</sup> Subsequently, the government established a Committee of Ministers to assess the Council's recommendations, the outcome of which was a comprehensive proposal for pension reform that was submitted to Congress on 15 December 2006 as the Pension Reform Bill.<sup>7</sup>

1.8 The objective of the proposed reform is to create a pension system that provides an effective social safety net for the entire population, strengthens the “solidarity” or welfare aspects of the system, expands coverage, and eliminates gender discrimination. To that end, ten major transformations have been proposed:

- (i) Create a Welfare-based Pension System (SPS) to provide old-age and disability benefits along with the benefits of the individual contribution system, through the Basic Welfare-based Pension (PBS)<sup>8</sup> and the Welfare-based Pension Contribution (APS).<sup>9</sup> These benefits will target people 65 years old or older who belong to the 60% low-income population.
- (ii) Create a new institutional structure that clearly reflects the responsibilities the State should assume in the area of pensions, and that ensures efficient delivery of benefits. The new Superintendency of Pensions (SUPEN) will oversee the entire pension system. The new Social Security Institute (IPS) will be responsible for administering the SPS and the pension systems currently being managed by the INP. The IPS will provide basic pension services to the public through a network of Integrated Pension Service Centers (CAPRI).
- (iii) Promote greater citizen participation in the system by creating a Users' Commission (workers, pensioners, and system administrators) and a Pension Education Fund.
- (iv) Promote greater gender equity in the pension system by giving women preferential access to the SPS (since it will not require a specific number of payments, which is an obstacle of the current system that works against women employed on an irregular basis), creation of a

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<sup>6</sup> The report is available for consultation at: <http://www.consejoreformaprevisional.cl/view/presentacion.asp>.

<sup>7</sup> The bill is available for consultation at: <http://www.gobiernodechile.cl/reforma%5Fprevisional/>.

<sup>8</sup> A benefit designed for those who did not contribute to the mandatory contribution system and have no other type of pension. The PBS will provide US\$140 monthly per beneficiary.

<sup>9</sup> A benefit that supplements the pension of those who have contributed to the mandatory contribution system and are entitled to receive a pension. The supplement tapers off to zero for pensions amounting to US\$370 monthly per beneficiary.

per-child allowance, and separation by gender of bidding for disability and survivors' insurance.

- (v) Increase the coverage of self-employed workers by providing equal access to pension benefits and by implementing gradual mandatory enrollment of all workers in the pension system.
- (vi) Increase the coverage of young workers by subsidizing the real monthly payments of young, low-income workers during their first 24 months of employment.
- (vii) Promote greater competition among the AFPs with a view to lowering fees and improving terms for members.
- (viii) Create conditions for the pension funds to earn better returns by expanding investment alternatives.
- (ix) Enhance voluntary pension saving mechanisms by creating the Collective Voluntary Pension Savings Program (through which workers' savings will be supplemented by employer contributions), modify tax treatment of voluntary savings, and create the Voluntary Member.
- (x) Ensure the transparency and financial sustainability of the pension system by creating a budget system that includes fiscal commitments to the pension system.

- 1.9 The government has designed a funding proposal for the pension reform process that maintains discipline in fiscal management and strict fiscal policy enforcement based on the structural surplus. The principal funding sources proposed are: (i) the Pension Reserve Fund; (ii) funds freed up as State commitments to the previous pension system are phased out (reduction of the deficit of the INP-administered pension system and interest earned on acceptance bonds); (iii) funds obtained as a result of reallocations, efficient spending, and economic growth; and (iv) in the first few years, a share of the interest earned on the financial assets of the national treasury.

#### **D. The country's sector strategy**

- 1.10 Better social safety nets for the population, especially the population at highest social and economic risk, is considered indispensable for national development and has been targeted as a key objective by the current administration. The government has pledged to set up a social protection system that covers citizens throughout their lives with better jobs as well as improvements in the educational, health, housing, and social security systems. Within this framework, pension reform will seek to improve the individual contribution system for the express purpose of enhancing the pension system's capacity to effectively protect workers from risks associated with old age and disability. The government's strategy is that the reform should increase the regularity and density of pension contributions, eliminate

discrimination against women and low-income workers, and improve the returns on workers' contributions.<sup>10</sup>

**E. The Bank's sector strategy**

- 1.11 The program will help achieve the objective set in the Bank's Country Strategy with Chile (document GN-2431) to reduce opportunity gaps in Chile by strengthening the social protection system. More specifically, the strategy pinpoints pension reform as an area for collaboration between the Bank and government, and offers support for implementing the reform under way (see paragraph 3.10).
- 1.12 The program fits into the Bank's Strategy on Social Development (document GN-2241-1) and Strategy for Modernization of the State (document GN-2235-1). With regard to the social development strategy, it addresses the objective of implementing a human development agenda to foster successful transitions from one life stage to the next (see paragraph 4.25). More specifically, it is aligned with the strategy directives to: (i) support governments in the design of comprehensive and sustainable pension systems, paying particular attention to the protection of low-income workers and gender issues; (ii) tailor pension system reforms to local socioeconomic and institutional features; and (iii) enhance pension coverage for the elderly poor (see paragraph 4.33 to 4.35). With regard to Modernization of the State, the program contributes to the strategy objective of greater efficiency of public management in the design and execution of policies that foster growth and address the needs of excluded sectors.

**F. The program strategy**

- 1.13 The Government of Chile has requested an investment loan from the Bank to support its efforts to upgrade the pension system's institutional features, management processes, and information systems. The program's actions will take into account the target image of the pension system developed by the Chilean government, which was included in the pension system reform bill. It describes the institutional and management features and the citizen involvement required to implement that vision. Thus, the program concentrates on three areas: (i) strengthening institutional capacity for pension system management and supervision; (ii) improving the administration of noncontributory benefits; and (iii) building citizen confidence in the system. Although these actions are aligned with the government vision that frames the proposed reform, they will help improve the operation of the system regardless of whether any change is made in the legal framework.

**G. Coordination with other official development finance institutions**

- 1.14 The International Labor Organization (ILO) is currently providing technical assistance to the finance ministry's Budget Office for updating the model used to project fiscal commitments associated with Chile's pension system. This activity

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<sup>10</sup> [http://www.gobiernodechile.cl/programa\\_bachelet/pgm\\_gob\\_proteger.asp](http://www.gobiernodechile.cl/programa_bachelet/pgm_gob_proteger.asp).

complements the program's actions to strengthen capacity for pension policy formulation and evaluation (Component 1).

## H. Lessons learned

- 1.15 The following lessons have been learned from multiple Bank operations relating to pension management:<sup>11</sup> (i) before designing the program, pension reform requires a careful and thorough preinvestment and technical analysis; (ii) the different institutional levels engaged in the system (policy definition and implementation, administrative services, regulation and enforcement mechanisms) must be identified and given sufficient autonomy; (iii) efforts should focus on solving problems related to user services, so as to ensure that the program contributes to providing the services and information needed by users; subsequently, efforts can concentrate on back-office processes to ensure efficient delivery of quality services; (iv) for the reform process to be effective, it is of critical importance to collect and disseminate information in order to build support for reforms that require consensus; (v) programs such as this are of significant importance to society and strongly attract the attention of the media and public opinion; therefore, an efficient campaign is needed to disclose specialized and transparent financial information on the pension system; and (vi) programs involving multiple agencies with different capacities need to clearly define and reach agreement on the outcomes.

## II. THE PROGRAM

### A. Objectives

- 2.1 The purpose of the program is **consistent and coordinated management and better performance of the civil pension system with more efficient benefit administration and greater user participation and confidence**. The following specific objectives follow from that purpose: (i) strengthen the pension system's policy-making, supervision, coordination, and evaluation functions in order to improve operational consistency and coordination; (ii) improve the administration of noncontributory benefits and the benefits of the previous system,<sup>12</sup> making pension information systems more integrated, efficient, and transparent and enhancing the performance of customer service mechanisms; and (iii) strengthen

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<sup>11</sup> TC-8905088-BO: Support for Financial Management of Social Security (approved in 1989); AR-L0201: Provincial Pension Reform Program (approved in 1996); UR-0108: Social Security Reform Program (approved in 1996); TC-9805063-BO: Program to Implement Pension Reform (approved in 1999); VE-L0100: Social Security Reform (approved in 1998); BR-0327: Support for Modernization of Pension System Management (approved in 2001); NI-L0101: Pension System Reform (approved in 2002); PE-L0211: Fiscal Reform Program (approved in 2002); CO-L0265: Health System and Social Security Reform (approved in 2003); and CH-T1021: Integration of Gender Perspective in the Pension Reform System of Chile (approved in 2006).

<sup>12</sup> Generic references in this document to the "previous" or "old" system refer to pension regimes of the former social insurance funds and the Social Security Service, which are currently administered by the Pension Standardization Institute (INP)

user participation in the pension system and promote activities to develop a greater sense of responsibility among users of the pension system and citizens as a whole.

- 2.2 The program goal is to help build a pension system that provides an effective and sustainable social safety net for the entire population, strengthens the welfare or “solidarity” aspects of the system, expands its coverage, and eliminates gender discrimination.

## **B. Structure**

- 2.3 The program has three components that address the specific objectives described in paragraph 2.1.

### **Component 1: Management and coordination of the pension system (US\$2,643,000)**

- 2.4 One of the pension system’s most striking features is its weakness in the areas of policy implementation, policy coordination, and capacity to analyze the system as a whole. The following agencies are involved in *policy implementation and supervision*: the Ministry of Labor (MINTRAB); MINTRAB’s Social Security Division (SSPS) and Labor Department (for inspections); the Superintendency of Social Security (SUSESO); the Ministry of Finance (MINDHA), acting through its Budget Office (DIPRES); the Ministry of Planning (MIDEPLAN); the Superintendency of Pension Fund Managers (SAFP); the Pension Standardization Institute (INP); and the Office of the Chief of Staff to the President, as well as local and municipal governments in the case of noncontributory pensions. Each is involved in the pension system to the extent that it impacts their areas of jurisdiction, but no single entity can provide a comprehensive overview and single perspective on the social security system. The systems’ capacity for *policy coordination* has a similar weakness. As a result, the SAFP plays the leading role because of the size of the system it manages. The Ministry of Finance also plays an important role, through DIPRES, in dealing with fiscal repercussions. There is no government policy-setting institution that addresses the direct relationship between job market regulation and the pension system. With regard to *actuarial projections and analysis*, the government has no strategic analysis center tasked with thinking about the future of the system as a whole and promoting the necessary adjustments. This fragmentation, both institutional and in terms of strategic information about the system, hampers the ability to proactively address the impact of changes in demographics and the job market on the pension system.
- 2.5 Given these shortcomings, this component seeks to strengthen the pension system’s policy-making, supervision, coordination, management, and evaluation functions, in order to improve operational consistency and coordination. Four lines of action will be pursued:
- 2.6 **Strengthen the capacity of MINTRAB’s Social Security Division (SSPS) to coordinate, formulate, and evaluate pension policy.** This will include actions to: (i) analyze and redesign the SSPS’s structure and staffing; (ii) design and institute

- policy analysis and planning tools; (iii) design strategies for expanding coverage and increasing contribution density; (iv) design and develop a balanced scorecard for monitoring performance and decision-making in the pension system; (v) design management tools for monitoring the performance of the institutions in the system; (vi) analyze the impact of pension policies on specific target populations (e.g. young people, women, active workers over the age of 50); and (vii) train SPSS staff in pension policy formulation and evaluation.
- 2.7 **Strengthen the system's supervisory and regulatory capacities.** These activities seek to build the institutional capacity of the system's supervisory and regulatory bodies and will include: (i) functional analysis of the organizational structure of SAFP and SUSESO; (ii) analysis of current staffing and assessment of new human resource needs; (iii) staff training on pension system regulation and supervision; and (iv) computer upgrades. This line of action will also work to improve system supervision and regulatory processes and activities through: (v) studies to identify good practices in the regulation of public-sector agencies; (vi) design and implementation of rules and procedures for effective supervision and regulation of the system; (vii) development of information technology systems to facilitate supervision and regulation, and (viii) documentation and compilation of the regulations governing the former social pension funds, the Social Security Service, and the pension fund managers (AFPs). Lastly, this line of action will help to develop new regulatory processes, including: (ix) regulations to enhance the voluntary contributory system; (x) instruments to promote price competition and efficiency among system operators; (xi) streamlining of the disability accreditation system; (xii) proposals for integrating and strengthening supervision processes and the collection of pension contributions; and (xiii) design and implementation of a plan to improve the investment framework.
- 2.8 **Strengthen the agency that administers noncontributory benefits and the benefits of the previous system.** This line of action will help create better organizational conditions for effective execution of the Component 2 activities. It includes: (i) analyzing the agency's functions and organizational structure; (ii) updating of rules and regulations; (iii) determining the necessary professional competencies and skills; (iv) analyzing human resource and staffing needs; and (v) training.
- 2.9 **Management of institutional change.** This line of action will focus on steadily improving the organizational performance of pension system institutions. It includes: (i) studies for enhancing institutional performance; (ii) technical assistance for designing and implementing strategies for organizational enhancement and change management; and (iii) training.
- 2.10 The component will finance consulting activities, training, and the procurement of office and computer equipment.



## **Component 2: Administration of noncontributory benefits and the benefits of the previous system**

- 2.11 Two main problems are associated with noncontributory pensions and the pensions provided under the previous system: the inefficiency of benefit delivery processes and the uncertainty surrounding the amount of the pension finally granted. Currently, it takes an average 52 and 22 days, respectively, to award benefits under the former social security funds and under the Social Security Service. This notwithstanding, user satisfaction with the services provided is 90%.<sup>13</sup> Three causes underlie these inefficiencies: (i) worker employment histories are not organized fully and systematically documented (a requisite for granting benefits or acceptance bonds), which makes automatic generation of individual accounts impossible as workers' labor histories have to be reconstructed manually; (ii) pension benefits are calculated manually, which may introduce errors into pension estimates; and (iii) the information technology systems used in pension administration are technologically and functionally obsolete, causing instability and interruptions. Lastly, although substantial improvements in quality and facilities have been made in recent years at local offices and customer service centers, it still takes too long to process transactions, and the information available to beneficiaries is lacking.
- 2.12 Given these issues, this component seeks to improve the administration of noncontributory benefits and the benefits of the previous system, promoting greater integration, efficiency, and transparency of pension information systems and user services. Activities have been organized into three subcomponents, as follows: (i) streamline core processes directly related to benefit administration; (ii) improve the integration, efficiency, and transparency of pension information systems; and (iii) improve the design of customer service mechanisms or adapt user services infrastructure to optimize service delivery and provide better information. The three subcomponents are described below.

### **Subcomponent 2.1: Streamline the core processes of benefit administration (US\$4,830,000)**

- 2.13 The objective of this subcomponent is to efficiently organize the administration of noncontributory benefits and the benefits of the previous pension system, in order to ensure a steady income stream,<sup>14</sup> and for beneficiaries of the previous system, to ensure that approved benefits correctly reflect their contribution history. This will involve the following: (i) reengineering benefit recognition and calculation processes; in essence, this will involve upgrading employment history management

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<sup>13</sup> INP, *Informe de Gestión Institucional* [Institutional Operations Report], 2006. The most likely explanation for the apparent inconsistency between the amount of time it takes to award a pension and degree of user satisfaction is that, by and large, people who visit INP centers do not go solely for the purpose of requesting benefits; therefore satisfaction does not relate exclusively to response time.

<sup>14</sup> At present, it is very likely that someone who requests a pension will experience an interruption in income; in other words, the time between the last wage received and the first pension payment will be more than thirty days.

by digitizing all INP information; (ii) reengineering the processes for paying noncontributory pensions; (iii) modernizing and automating the calculators used in INP-administered pension systems; (iv) reengineering the processes for determining and paying benefits; (v) reengineering the process for paying survivors' pensions; (vi) reengineering the processes for managing overdue pension contributions as well as collection mechanisms; and (vii) improving general administrative processes linked to benefit administration. It is considered that this subcomponent requires that a technical team be created to implement the new processes so as to ensure that they are used by all the system's agencies; the necessary equipment is included.

- 2.14 This subcomponent will finance consulting services, training, and the procurement of computer and office equipment.

**Subcomponent 2.2: Modernize and integrate information systems  
(US\$6,825,000)**

- 2.15 The information systems used by the INP for pension management were developed by an external supplier more than 10 years ago.<sup>15</sup> Maintenance and operation were outsourced in 1997 to the same firm (the contract expires in March 2009). Development of these systems has not followed a plan responding to management needs that emerged over time; rather the systems were adapted to problems as they arose. The information systems do not meet all the management and monitoring needs of the pension system, they are linked to management processes that need to be improved (see Subcomponent 2.1), and they are characterized by: (i) being very obsolete, which causes instability and interruptions; (ii) a low level of integration, which affects information quality and management, and requires a considerable amount of manual intervention in administrative processes; (iii) inflexibility, which makes it difficult to adapt the systems; and (iv) complete dependency on the outsourced service provider. In addition, the INP's weak capacity to design and manage outsourced information technology projects has delayed the incorporation of new, more modern, integrated, and streamlined systems for handling pension management needs. In this connection, the INP is completing the development of an integrated platform of systems,<sup>16</sup> based on Web-application architecture, with the intention of substantially upgrading information technology services in several areas of pension management. The INP recognizes the need to complete the technological modernization process it has begun by developing and integrating new systems and reducing dependency on a third party. To do so, it must upgrade its own capacities in the areas of maintenance and operation.

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<sup>15</sup> The INP currently uses seven computer systems and as many as 17 databases for managing the pension system: most have client-server architecture, and integration is very limited. The pension award and payment systems were developed approximately 30 years ago and have been adapted in response to new functional requirements of the pension award and payment processes.

<sup>16</sup> *Proyecto Ágil* is designing systems that will provide information technology support to the following areas: collection, pension history, debt control and collection, acceptance bonds, revenues and payments, and accounting interface.

- 2.16 Given the foregoing, the objective of this subcomponent is to improve management and the quality, efficiency, and transparency of services provided to participants and retirees by strengthening information technology management capacities in the pension system, and by completing the work to modernize and integrate the information systems. To achieve these objectives, three lines of action will be pursued:
- 2.17 **Design a technological strategy for comprehensive pension system management.** A technological strategy will be designed, based on the business model of Chile's pension system and taking advantage of the improved management processes (Component 2.1). To that end, the following will be analyzed and designed: (i) a map of information systems, which will include the requirements for integrating these systems and the systems of other institutions involved in pension management; (ii) a plan to reuse and adapt existing systems or those being developed in line with the new systems map; (iii) an online catalog of pension services to be offered via Internet to beneficiaries and retirees; (iv) a model of the technological architecture of the systems to be developed, distinguishing between the following levels: platform, development, application, data, integration,<sup>17</sup> security,<sup>18</sup> and communications; (v) a plan to outsource and recover information technology functions (systems development, operation, and support); and (vi) a design of the organizational framework needed to manage the information technology function of the pension system.
- 2.18 **Develop and introduce new information systems.** Considering the findings of the assessment of pension management support systems and the need to improve the management, quality, and transparency of users' services, it was determined that new information systems were necessary (some to replace legacy systems). The program will finance the design and incorporation of the following systems:
- a. Pension eligibility, award, and payment system. This is a core system of pension management, along with the contribution collection and pension history systems, which are currently being designed. This system will process transactions required for determining eligibility, and for calculating, awarding, and paying benefits.
  - b. A data warehouse to facilitate pension system analysis and monitoring. This system will fulfill a key function in pension monitoring and management system, and will be connected to the financial analysis, simulation, and

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<sup>17</sup> The integration architecture will define the specifications for developing interoperability services between the INP's systems and those of the other actors of the pension system. These specifications should be compatible with those of the integrated platform of e-services, which is being designed under the Reform and Modernization of the State Project (PRyME), and which includes development of interoperability services between the INP, Internal Tax Service (SII), Civil Registry and Identification Service (SRCeI), and General Treasury of the Republic (TGR), among other institutions.

<sup>18</sup> The security architecture will define the criteria and specifications needed to safeguard confidentiality, data integrity and availability, the information systems, and the communication networks.

projections system used by DIPRES to analyze and forecast the fiscal impact of the pension system.

- c. A pension website, offering more and better information and services online via the Internet. It will be user-friendly and intuitive, and will aim to increase transparency and facilitate access to information and transactions. Activities will be undertaken to encourage greater use of online services and transactions.
  - d. A Customer Relationship Management (CRM) system, connected to the call center, to improve the services offered to beneficiaries and retirees at customer service centers, by telephone, or via Internet.
  - e. Information systems to support institutional administration (see paragraph 2.6 iv), including development of a pension regulation information system.
  - f. Improvements in and adaptations to existing systems in order to integrate them with the new systems.
- 2.19 **Upgrade technological infrastructure (hardware).** The development and installation of new information systems, and the improvement of existing systems, requires upgrading and expanding system hardware. Under this line of action, the program will finance the procurement of servers as well as storage, security, and network devices; upgrade the communication network's data transmission capacity;<sup>19</sup> and refurbish a DataCenter or Computer Center where information technology can be safely kept.
- 2.20 This subcomponent will finance consulting services, training, and the procurement of computer and office equipment.

**Subcomponent 2.3: Improve customer service mechanisms (US\$8,759,400)**

- 2.21 This subcomponent aims to improve service mechanisms for users of the pension system, diversify information channels, facilitate online transactions, and provide comprehensive information on pension benefits. To this end, this subcomponent will: (i) diagnose INP services, which will include carrying out a nationwide survey and assessing the physical infrastructure and human resource needs of customer service offices; (ii) design a new user services network model, based on the outcomes of the two preceding subcomponents; this will include redesigning the services and procedures to be offered, the services provided to different target populations, the types of customer services facilities, their geographical distribution, and the technical skills of human resources; (iii) design the corporate image for the new user service network; (iv) draw up a plan for implementing the

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<sup>19</sup> For approximately one year now, the INP has been operating a nationwide communications network that interconnects 64 branches, 77 customer service centers, and 13 regional offices, while also offering IP telephony.

- network; (v) gradually implement customer service offices, which will include remodeling physical facilities and upgrading or furnishing computer equipment.
- 2.22 This subcomponent will finance consulting services, training, the procurement of computer and office equipment, and remodeling users' services facilities.

**Component 3: Strengthen participation and pension awareness (US\$6,557,000)**

- 2.23 Certain cultural factors undermine citizens' confidence in the pension system and their behavior as users of the system. First, the studies conducted or analyzed by the Presidential Advisory Council on Pension Reform revealed that, although people are aware of the importance of foresight in ensuring better quality of life in old age, they seemingly underestimate life expectancy and overestimate the possibilities of continuing to work after they retire. Second, studies show a high degree of uncertainty among workers as to how they will support themselves in their old age. This is reflected in the fact that many prefer not to think or talk about it, or they harbor expectations that some successful enterprise will generate sufficient revenues to meet their needs in the future. Third, although the principle of saving for one's old age through the pension system is highly regarded, there is little confidence in the institutional mechanisms of the pension system. For one, there is mistrust toward a pension system that relies strongly on private agencies (AFPs).<sup>20</sup> Also, the tacit assumption that a male, salaried head of household with a stable job is the basis of the current system generates mistrust, because it is insensitive to the real employment and family situations of many users (especially women, the self-employed, and irregular workers). Fourth, pension system users have very limited knowledge of the benefits to which they are entitled under the system.<sup>21</sup> All these factors combine to create an attitude of mistrust toward the pension system, which is further aggravated by the absence of mechanisms that enable users to express their opinions and monitor the performance of the institutions of the system.
- 2.24 Taking into account the foregoing, the objective of this component is to strengthen users' involvement in the operation of the pension system, and to develop a greater sense of pension awareness and responsibility among plan members and citizens as a whole. This should include heightening awareness of the risks associated with old age, improving the understanding of the relationship between contributions and

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<sup>20</sup> This mistrust does not stem from AFP users' perception of service quality (only 34% rate the service poorly), but rather from the ideological preferences of the population, which does not like private agencies to be involved in public policies. A study commissioned by the Advisory Council showed that 80% of Chileans consider that the pension system should be the responsibility—at least in part—of the State.

<sup>21</sup> The 2002 and 2004 Social Protection Surveys showed that between 70% and 80% of respondents did not know how their pensions were determined, did not recognize the relationship between their pensions and their contributions (78% did not know how their pensions were calculated and 8% believed that their pensions were based on the wages of their last few years of work), and were not familiar with the basic information on the minimum guaranteed pension and its requirements.

benefits, and enhancing citizen confidence in the public and private institutions of the system.

- 2.25 This will involve: (i) conducting market research and analysis, and researching good practices in pension education and communication; (ii) designing a communications strategy; (iii) designing a pension education strategy; (iv) designing and executing a communications and information plan on pension rights targeting citizens and plan members; (v) designing a mechanism for engaging users in the operation of the pension system; and (vi) designing mechanisms for promoting pension education initiatives (competitive funds, school programs, website, etc.).
- 2.26 This component will finance consulting services, training, and dissemination activities.

### C. Cost and financing

- 2.27 The cost of the program is US\$35 million. The IDB will contribute US\$17.5 million from its Ordinary Capital, and the local counterpart contribution will be US\$17.5 million. The program budget is shown in Table II-1.

**Table II-1**  
**Budget (US\$)**

COMPONENTS	IDB	Local	Total	%
<b>1. Management and coordination of the pension system</b>	<b>1,728,800</b>	<b>914,200</b>	<b>2,643,000</b>	<b>7.6</b>
<b>2. Administration of noncontributory benefits and benefits of the previous system</b>	<b>9,453,680</b>	<b>10,960,720</b>	<b>20,414,400</b>	<b>58.3</b>
2.1. Improvement of core benefit administration processes	2,716,000	2,114,000	4,830,000	
2.2. Integration of information systems	6,710,000	115,000	6,825,000	
2.3. Improvement of customer service mechanisms	27,680	8,731,720	8,759,400	
<b>3. Participation and pension awareness</b>	<b>4,617,520</b>	<b>1,939,480</b>	<b>6,557,000</b>	<b>18.7</b>
<b>4. PROPEF</b>	<b>1,000,000</b>	<b>400,000</b>	<b>1,400,000</b>	<b>4.0</b>
<b>Direct costs (1+2+3+4)</b>	<b>16,800,000</b>	<b>14,214,400</b>	<b>31,014,400</b>	<b>88.6</b>
5. Program management	400,000	1,500,000	1,900,000	<b>5.4</b>
6. Final evaluation	0	50,000	50,000	<b>0.1</b>
7. Contingencies	300,000	0	300,000	<b>0.9</b>
8. Financial expenses	0	1,735,600	1,735,600	<b>5.0</b>
9. Inspection and Supervision Fund	0	0	0	<b>0.0</b>
<b>Indirect costs (5+6+7+8+9)</b>	<b>700,000</b>	<b>3,285,600</b>	<b>3,985,600</b>	<b>11.4</b>
<b>GRAND TOTAL</b>	<b>17,500,000</b>	<b>17,500,000</b>	<b>35,000,000</b>	<b>100.0</b>

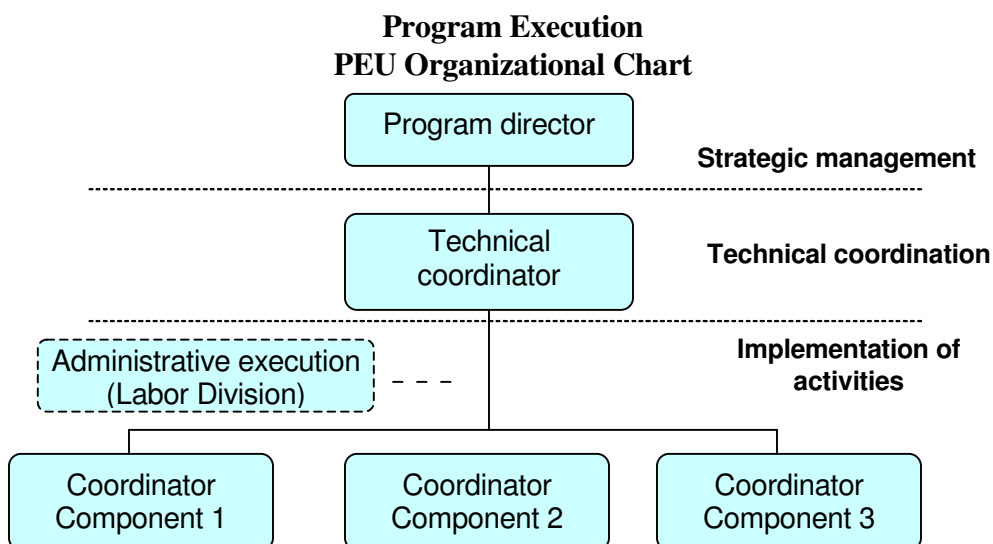
### III. PROGRAM EXECUTION

#### A. Borrower and executing agency

- 3.1 The borrower will be the Republic of Chile. The executing agency will be the Ministry of Labor and Social Security (MINTRAB). The program will be executed by a program execution unit (PEU) reporting to the Minister of Labor and Social Security. The administrative procedures necessary for program execution will be handled by MINTRAB's Social Security Division (SSPS).

#### B. Program execution and management

- 3.2 The program will be implemented by the program execution unit (PEU), under the leadership of an **executive director**, who will answer directly to the Minister of Labor and Social Security. The executive director will be responsible for the strategic management of the program, and for directing and supervising all program activities. A **technical coordinator** will be responsible for coordinating execution of the technical aspects of the program's substantive actions, and this person will report directly to the executive director. The technical coordinator will direct and supervise the work of the three **component coordinators** who, in turn, will oversee the work of the consultants and/or staff making up the teams of each component. The component coordinators will receive the support of pension system services and institutions for executing of program actions. These entities will create a technical liaison team to work with the PEU to facilitate the organization of activities with pension institutions. The SSPS will handle the administrative procedures necessary for program execution. Nevertheless, the PEU may have qualified professional and technical staff to provide legal and administrative support for the procurement process. The PEU organizational chart is shown below.



**C. Special contractual clauses**

- 3.3 As a condition precedent to the first disbursement of the loan proceeds, the executing agency will provide evidence, to the Bank's satisfaction, that: (i) the program execution unit (PEU) is up and running and has been allocated the resources and necessary staff to operate; and (ii) recommendations arising from the Bank's institutional capacity assessment of the SSPS have been implemented; and (iii) the program execution plan (PEP) has entered into force.
- 3.4 To finance the expenditures included in the program's procurement plan (Annex III) for the first six months of execution, expenditures charged to the counterpart and expenditures charged to the loan, for up to the equivalent of US\$400,000 each, made between 1 February 2007 and the date the loan operation is approved, will be recognized for the counterpart, and reimbursed to the loan. Eligible program expenditures may be recognized provided procurement procedures substantially analogous to those of the Bank were used.

**D. Procurement**

- 3.5 Works, goods, and related services, and consulting services will be procured in accordance with Bank policies on procurements and on the contracting of consultants. International competitive bidding (ICB) will be used to procure works and goods whose estimated value is more than US\$5 million and US\$350,000, respectively. National competitive bidding (NCB) will be used to procure works and goods whose estimated cost is equal to or more than US\$350,000 and US\$100,000, respectively; the public e-procurement procedures established by Law 19,886 (ChileCompra) will be used for national competitive bidding procedures. Prudent shopping will apply for works and goods whose estimated cost is below US\$350,000 and US\$100,000, respectively. The short list for consulting services whose estimated cost is less than the equivalent of US\$500,000 may be made up exclusively of national consultants. The Bank will conduct ex ante evaluations of contracts that exceed NCB thresholds; in the case of consulting services, ex ante evaluations will be performed for contracts with consulting firms valued at more than US\$200,000, and for contracts with individual consultants exceeding US\$50,000.
- 3.6 SYNAPSIS will provide the consulting services for the design and development of adaptations to the noncontributory benefit administration and payment system. This outsourced service provider has been responsible for the development, maintenance, and operation of the INP's information technology systems since 1997. Direct contracting of these services—for up to US\$450,000—is justified for the following reasons: (i) the benefit award and payment system was developed by SYNAPSIS more than 10 years ago and it has been responsible for maintaining and operating the system ever since; and (ii) SYNAPSIS is the only company familiar with the system's technical architecture and therefore the only one that can adapt the system with a likelihood of success, with lower risk, and within a reasonable period of time while at the same time ensuring full operation of the systems.



**E. Execution and disbursement schedule**

- 3.7 The program's execution period will be thirty (30) months. Disbursements will be made over a 3-year period, in accordance with the tentative schedule shown below in Table III-1.

**Table III-1. Tentative disbursement schedule (US\$)**

	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>	<b>TOTAL</b>
Amount	5,711,840	11,258,160	530,000	17,500,000

**F. Revolving fund**

- 3.8 The executing agency will open separate bank accounts for the loan proceeds and for local counterpart funds. Once all the precedent conditions for the first disbursement have been met, the Bank may advance funds not to exceed 20% of the loan to create a revolving fund. Justifications for the magnitude of the revolving fund are the short execution period and the pace of procurement needed to keep the program flowing properly. Disbursement requests will be processed only against presentation of the reconciliation of the revolving fund, whenever the Bank disburses loan proceeds; they will take into account the progress made on the tasks and activities described in the AWP. The eligibility of expenditures will be determined once the Office of the Comptroller General of the Republic (CGR) has submitted its reports on the procurement and disbursement processes (see paragraph 3.14).

**G. Monitoring and evaluation**

- 3.9 On 10 January 2006, the Management of the Bank authorized a pilot program allowing flexible treatment and simplification of supervision procedures for Bank operations in Chile (CC-6066). This trial pilot program covered four projects and was based on the findings of a trust risk assessment conducted by the Bank. Toward the end of that year, that same instrument was used to assess new projects receiving simplified supervision. Application of the Institutional Capacity Assessment System (ICAS) at MINTRAB yielded positive results, including low risk in administrative and financial support functions. In order to extend the benefit of simplified supervision to the present program, MINTRAB was also submitted to a risk assessment. The outcome of the risk assessment of MINTRAB's trust and operational performance, development effectiveness, and quality, social, and environmental safeguards entitles the executing agency and the program to simplified supervision under the aforementioned pilot program, with emphasis on management for results. As a result, procedures for supervising procurements and for processing disbursement requests will be simplified.
- 3.10 The program execution plan (PEP) and procurement plan are the planning and control instruments to be used for the program. Delivery of the PEP will be a condition precedent to the first disbursement. A procurement plan covering the first

18 months of the program has also been prepared (see Annex III). The updated PEP and procurement plan for the following period will be delivered to the Bank for consideration by 30 December each year.

- 3.11 The progress of program activities and outcomes will be monitored against the indicators included in the logical framework (see Annex I) via annual progress reports delivered by the executing agency within 60 days after the end of each calendar year. In this connection, the Government of Chile also requested the Bank for technical assistance from the project team for monitoring program execution in the future, due to the program's complexity and the risk profile identified for implementation (see paragraph 4.9).
- 3.12 An independent final evaluation and the project completion report (PCR) prepared by the Bank are the instruments that will be used to evaluate the program. The independent final evaluation may be contracted with program resources and will be performed three months after the end of program execution.

#### **H. Internal control, financial statements, and audit**

- 3.13 The executing agency will maintain accounting systems satisfactory to the Bank, as well as an effective, complete, and up-to-date filing system for all supporting documentation related to the program's financial and accounting management, including a record of all procurements made within the framework of the program.
- 3.14 The program's annual financial statements will be submitted to the Bank within 120 days after the close of each fiscal year. The audit will be performed annually by the CGR in accordance with Bank standards and procedures. In addition, a midterm report on procurements and payments will be prepared for the first six-month period of each year, to be audited by the CGR and submitted to the Bank each 30 October. In addition to examining the financial statements, the audit reports will cover compliance with contractual clauses, the execution of procurement processes, and internal audit procedures.

#### **I. Currency**

- 3.15 The loan will be financed in United States dollars from the Single Currency Facility of the Bank's Ordinary Capital, under the Local Currency Facility (LCF) (document GN-2365-2 of 4 November 2005). To minimize exchange risk, the Government of Chile will be entitled under the terms of the LCF to convert program disbursements and outstanding balances into pesos. To expand funding opportunities for the borrower, the conversion of program disbursements and outstanding balances into local currency will be subject to two financing terms in addition to those established for the LCF: (i) more flexible amortization profiles for disbursements in local currency, as described in Annex IV, section 2(a); (ii) pricing based on the Bank's actual funding costs in the event that it secures funding through bond issues, as indicated in Annex IV, section 2(b). The conversion of program disbursements and outstanding balances into local currency will require a

*waiver of the LCF* as it relates nonapplicability of the *clause on the interruption of Bank access to financing* (see Annex IV, section 3).<sup>22</sup>

#### **IV. VIABILITY AND RISKS**

##### **A. Viability**

- 4.1 Two factors underpin program viability: (i) the clear and express political determination of the highest-level government authorities to improve the pension system, an opinion shared by the opposition political parties in Congress, which is currently examining the pension reform bill; and (ii) the technical quality and very specific nature of the proposal to reform the pension system submitted by the government to Congress, based on the expert work of the Presidential Advisory Council and the expressed concerns of beneficiaries and citizens as a whole (see paragraph 1.7). These two factors give MINTRAB a clear mandate to spearhead reform of the pension system, as well as clarity regarding the measures to be implemented once the Pension Reform Act has been approved by Congress. Placing the program execution unit in MINTRAB, directly under the responsibility of the Minister, will promote more effective execution of program actions. Although not dependent on the aforementioned law, program actions are consistent with the government's guidelines for reform (see paragraph 4.8).
- 4.2 According to the Institutional Capacity Assessment System (ICAS), the institutional capacity of MINTRAB's Labor Division is satisfactory for performing the tasks assigned to it under the program. The assessment included some specific recommendations: (i) prepare a flow chart of programming activities; (ii) design procurement procedures that include international competitive bidding; (iii) spell out the financial relationship between the program and MINTRAB; (iv) include the program in the audit plan; and (v) agree on the program's monitoring mechanisms with the Labor Division's management control section. (The ICAS assessment report is available for consultation in the RE1/SC1 files: 983330.)

##### **B. Social and environmental impact**

- 4.3 Program activities will benefit users of the pension system, with special emphasis on socially excluded sectors including low-income workers and women. This operation therefore qualifies as a social equity enhancing project, as described in the indicative targets mandated by the Bank's Eighth Replenishment (document AB-1704). It does not qualify as a poverty-targeted investment (PTI).
- 4.4 The activities financed by the program are not expected to have a direct or indirect environmental impact. The project concept document for this operation was approved by the Committee on Environment and Social Impact (CESI) on

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<sup>22</sup> That clause provides that, if the Bank's funding in local currency is interrupted and it cannot secure other funding, the Bank may revert the local currency conversions to convertible currency.

9 February 2007, with no recommendations for actions to mitigate possible environmental impact.

### **C. Benefits**

- 4.5 The program will have a direct impact on improving the institutional and technical conditions for operating the pension system. As a result of the foregoing and of other actions planned by the Chilean government, the program is expected to help expand coverage of the pension system, increase contribution density, and provide more equitable access to benefits, all of which will improve protection against the risks of old-age poverty and disability. Although program activities will benefit all users of the pension system, they will have a stronger impact on users who currently have inequitable access to pension benefits, that is, low-income workers and women.
- 4.6 Low-income workers' employment histories are often characterized by unemployment, informal jobs, or inactivity, which generally results in low pension contribution density and the likelihood of receiving very low pensions. It is often even difficult for them to meet the requirements of the guaranteed minimum pension. The improvements in the administration of noncontributory benefits promoted by this program will help address these situations. Improved information systems will facilitate reconstruction of employment histories and expedite access to State-guaranteed pensions. Finally, improvement of customer service offices will provide low-income users with better access to needed information and services.
- 4.7 As a result of the unequal division of reproductive and domestic work, women are engaged in the job market on an irregular basis. Once in the job market, their labor and wage conditions are uncertain and unstable. This reduces the size of the individually funded accounts they can accumulate. Due to women's lower retirement age and greater life expectancy, they must be distributed over a longer period of time, creating low pensions and expanding the income gap that already exists between the genders in the active stage. The program-fostered improvement in the capacity for pension policy formulation and evaluation, combined with the creation of citizen participation mechanisms, is expected to make the system more sensitive to women's labor and family circumstances. This will help change the tacit underlying concept of a "male head of household beneficiary" and its impact on the pension system.

### **D. Risks**

- 4.8 Program execution carries two main risks. The first stems from the resistance of pension institutions to the proposed reforms. To counteract this risk, the PEU will respond directly to the Minister of Labor, who has authority over all entities of the system. In addition, the PEU will be staffed by a solid technical team, to ensure technical linkages with the different entities of the system. The second source of risk is the process for passage of the Pension Reform Act. Initial contacts between the government and the political parties indicate a solid consensus that it will be passed, most likely in the first half of 2008. Passage of this law will accelerate

program-supported changes and facilitate actions. The possibility that passage of the bill will be delayed or side-tracked will not affect program activities because they address management issues, institution-strengthening, information systems, and pension education, none of which requires changes in the current legal framework. Moreover, program achievements in these areas will enable more effective implementation of the reform once the bill is passed. A risk analysis exercise was performed as part of the project design process.

- 4.9 The risk assessment of the program performed during the appraisal mission found that overall program risk is low. (The findings of the assessment are available for consultation in the RE1/SC1 files: [983327](#).)
- 4.10 Given the program's risk profile, during program execution the Bank should:
  - (i) help the executing agency make sound and efficient use of procurement mechanisms and procedures;
  - (ii) assist the government in facilitating effective coordination and cooperation among the institutional actors involved in the program;
  - (iii) support the government in evaluating on an ongoing basis the impact of the policy environment on program implementation; and
  - (iv) strengthen capacity for technical monitoring of program execution and the achievement of development objectives.