Summary of the Chilean Pension System

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Introduction to the Chilean Three Pillar Pension System

The pension system in Chile is based on an individual capitalization scheme and was introduced in 1980. In 2008, President Michelle Bachelet introduced a reform, which set up the current three-pillar system:

The first is a redistribution / solidary government provided pillar, aimed for individuals belonging to the poorest 60% of the population. This pillar includes a base solidarity pension for individuals with no pension savings, a supplement to individuals with very small pension savings, a Survivor pension in case of death, a Child bonus for mothers, and a Young Workers Subsidy.

The second is a mandatory contribution pillar with individual capitalization accounts aimed for people in the workforce. All employees are obligated to contribute 10% of their salary. The contribution is deposited into the employee’s individual capitalization account. These mandatory saving accounts are managed by Pension Fund Administrators (AFPs). All contributors and pensioners pay a fee to the AFPs which is set by the AFPs and is a percentage of the contributors’ salary or a percentage of the pensioners withdrawal. Today there are six Pension Fund Administrators and each of them manage five Funds with different investment strategies.

The third pillar is a voluntary saving pillar with three different types of saving plans: Voluntary Pension Saving, Collective Voluntary Pension Savings and Voluntary Savings Accounts. This pillar is for voluntary contributors and is for those who want to obtain a greater pension than the mandatory savings alone. Tax benefits is an opportunity in this pillar.

Note

In Chile they use the Unidad de Fomento (UF) as a Unit of Account to represent the real value of any economic item. The exchange rate between UF and Chilean Peso (CLP) is today (June 26, 2018) equal to 27,147 CLO (or USD 43) and is constantly adjusted for inflation. The minimum wage in Chile is 10 UF (or USD 430) per month (January 2018)
**Summary of the Chilean Pension System**

**Retirement age**

The normal retirement age in Chile is 60 for women and 65 for men, but they are not obligated to retire at that age. However, the pension in pillar one is first payable from the age of 65 for both men and women. In the old pension system (before 1980) the retirement age was 55 for women and 60 for men. Figure 1 shows the development in the average age of retirement in Chile.

*Figure 1: Avg. Age of Pensioners*

Source: [www.spensiones.cl](http://www.spensiones.cl)

**Pillar 1: Redistributive / Solidarity Pillar**

This pillar is financed by general taxes and aimed for individuals with no or very little pension savings. The two main pensions in this pillar are: The Old-age Basic Solidarity Pension for individuals without any pension savings and Solidarity Pension Payments which are a supplement to individuals with a very small pension saving. Pensioners receiving Old-age Basic Pension or Solidarity Pension Payments do not pay for health coverage.
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The Old-age Basic Solidarity Pension (PBS)
The PBS is available for individuals with no pension savings and who meet the following requirements:

- 65 years of age,
- Belonging to the poorest 60% of population,
- Minimum 20 years of residency from the age of 20 years and resident for at least four out of five years prior to retirement,
- Not entitled to any pensions.

The PBS is a fixed amount and was USD 150 per month in December 2016. The amount is adjusted every year to account for inflation.

Solidarity Pension (APS)
The APS is a supplement to all individuals who have contributed to the mandatory pension system (see the section about Pillar 2) but have very little savings. Individuals are entitled to the APS if they meet the following requirements:

- 65 years of age,
- Belonging to the poorest 60% of the population,
- Minimum 20 years of residency from the age of 20 years and resident for at least four out of five years prior to retirement,
- The individual’s pension savings account must be below a specific threshold: Maximal Welfare Pension (PMAS), which was USD 490 in December 2016.

The APS is a supplement and is calculated according to the following formula:

$$APS = \begin{cases} PBS - \frac{PBS}{PMAS} \cdot PBase, & \text{if } 0 \leq PBase \leq PMAS \\ 0, & \text{if } PMAS \leq PBase \end{cases}$$

Where PBase is the sum of all self-funded pension plus any survivor pension the individual may receive. The 45-degree line in Figure 2 represent the case where the effective pension is equivalent to the self-financed pension. The orange line above represents the final pension with self-financed pension plus APS. Hence, if the individual has very low savings, they will receive a high APS and if the individual has a higher amount of pension savings, they will receive less APS but a higher final pension.
Child bonus for mothers

Mothers are granted a state-funded allowance for each child born alive or adopted. This benefit is equivalent to 10% of 18 monthly minimum wages starting in the month the child was born plus the average rate of return of the Type C Pension Fund (See the section about Pillar 2) from the date of birth until the benefit claim. Hence, at the time the child is born the amount is calculated and begins to generate return.

Women are entitled to this benefit at the time they reach the age of 65 years, have a minimum 20 years of residency from the age of 20 years and were a resident for at least four out of five years prior to retirement. In case of adopted children, this benefit is entitled to both the biological and adoptive mother.
Summary of the Chilean Pension System

If the woman is affiliated with an AFP, the allowance will be deposited in her individual account, increasing her pension. If then, the pension is less than the PBS and she is not qualified to the APS, she may request that her pension is increased to an amount equivalent to the PBS. If she is not affiliated with an AFP but is entitled to a PBS, a reference self-funded pension is calculated, and the amount is added to her old-age basic solidarity pension.

Other benefits
All individuals entitled to a PBS will be granted an additional benefit (Survivor Pension) in case of death. This benefit is paid to the person paying for the funeral expenses.

For young workers (between 18 and 25 years old) there exist a state-funded pension subsidy, which is equivalent to 50% of the mandatory contribution calculated using the minimum monthly wage. This benefit can be received during the first 24 month of contribution made by the worker and is added directly to his or her individual capitalization account.

Pillar 2: Mandatory Individual Accounts
This pillar is a defined contribution plan where each person has their own capitalization saving account. These saving accounts are managed by Pension Fund Administrators (AFPs). It is mandatory for all employees to contribute 10% of their salary into their individual saving account. On top of the contributions is an administrative fee (a percentage of the salary), which is set by the by AFP.

Contribution to this system is voluntary for self-employed workers. Voluntary members are individuals without wages who still choose to contribute. Figure 3 shows the number of affiliates compared with the number of contributors. It is clear that the number of contributors is much lower than the number of individuals affiliated to a AFP. During parental leave, the 10% contribution is paid for by the parental leave benefit.
Summary of the Chilean Pension System

Figure 3: Number of Affiliates and Contributors

![Graph showing the number of affiliates and contributors over time](source: www.spensiones.cl)

**Pension Fund Administrators (AFPs)**

The pension system is managed by Pension Fund Administrators (AFPs) which are private institutions. At the moment there are six AFPs in Chile and they are under supervision of the Superintendence of Pensions. Each AFP is obligated to provide five investment strategies, that is called Fund A, B, C, D and E. Table 1 summaries the amount of risk in each Fund and the possible choice of Funds for the members.

The Administrators are allowed to manage all five types of investment strategies, but it is mandatory to offer the four least risky strategies, hence Fund B, C, D and E. It is voluntary to offer the riskiest investment strategy, but to date all six Administrators include Fund A. All administrators are single-purpose companies since they are not allowed to directly or indirectly offer members other pensions (than the five Funds), services or benefits.
Members may place the balance of their mandatory savings account in any of the five Funds and even split the balance and place it in different investment strategies. However, there are limitations for male members over 55 years old, female members over 50 years old and pensioners. The possible choice of Funds are summarized in Table 1.

Table 1: Possible choice of Funds and the amount of risk in each Fund

<table>
<thead>
<tr>
<th>Fund</th>
<th>% of Equities</th>
<th>Men ≤ 55 years</th>
<th>Women ≤ 50 years</th>
<th>Men &gt; 56 years</th>
<th>Women &gt; 51 years</th>
<th>Default choice</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fund A: <em>Most Risky</em></td>
<td>40%-80%</td>
<td>✔️</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fund B: <em>Risky</em></td>
<td>25%-60%</td>
<td>✔️</td>
<td>✔️</td>
<td>Men ≤ 35</td>
<td>Women ≤ 35</td>
<td></td>
</tr>
<tr>
<td>Fund C: <em>Intermediate</em></td>
<td>15%-40%</td>
<td>✔️</td>
<td>✔️</td>
<td>36 &lt; Men ≤ 55</td>
<td>36 &lt; Women ≤ 50</td>
<td></td>
</tr>
<tr>
<td>Fund D: <em>Conservative</em></td>
<td>5%-20%</td>
<td>✔️</td>
<td>✔️</td>
<td>Men &gt; 56</td>
<td>Women &gt; 51</td>
<td></td>
</tr>
<tr>
<td>Fund E: <em>Most Conservative</em></td>
<td>0%-5%</td>
<td>✔️</td>
<td>✔️</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

If no investment strategy is chosen, the member will be assigned to a Fund according to his or her age (see column with default choice in Table 1). Hence, members up to 35 years old will be placed in Fund B, male members from 36 to 55 years old and female members from 36 to 50 years old will be placed in Fund C and male members over 56 years old, female members over 51 years old and pensioners will be placed in Fund D. However, once an individual chooses a Fund, he or she cannot go back to the default.

Members can freely transfer their savings between Funds, but the Administrators may charge an exit fee if a member transfers their balance more than twice during one calendar year. Figure 4 shows the numbers of member who have requested a transfer between Administrators and the number of members who have been rejected or accepted to transfer their balance between Administrators.
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Workers entering the workforce, hence new members of an AFP, are assigned to the most inexpensive Administrator, that is the AFP with the lowest fee per contribution. These members need to remain in the same AFP for a minimum period of time, but other members can change Administrators at any time.

Figure 4: Number of members, transfer between Administrators

Source: Superintendence of Pension, “The Chilean Pension System”, 2010

Regulations of Investment Fund Resources
AFPs may only invest pension fund resources in instruments that are mentioned in the law and authorized by Superintendence of Pensions, following a report by the Central Bank in Chile. Following instruments are authorized:

Government bonds issued by the Central Bank of Chile and the General Treasury of the Republic, as well as Pension Recognition Bonds.

Instruments issued by financial institutions, such as fixed-term deposits, promissory notes, mortgage bonds, stocks and bonds; public and private company bonds; exchangeable bonds; open joint-stock company stocks; investment fund and mutual fund shares; foreign capital investment fund shares; negotiable instruments issued by private companies; and foreign instruments.
Pension fund resources may only be invested in risk category N-1, N-2 and N-3 for short-term instruments and AAA to BBB for long-term instruments. Further, there are several limitations to the portfolio according to the type of fund (see Appendix A for details about the limitations).

**The Fee**

The fee is also known as the additional contribution. For active members the fee is a percentage of salary on top of their contributions, and for pensioners the fee is a percentage of the withdrawal. The AFP use the fee to finance their operations. The following principles are used to set the level of the fee:

- The fee is set freely by the AFP, within the structure of the law
- In each AFP, the fee must be uniform for all Funds and members.

These principles are set by the Pension Fund Laws. The fee is a price of a service and it includes the cost of the disability and survivor insurance. Since members can change their Administrator at any time, the competition between these Administrators is assumed to produce an appropriate level of fees. Figure 5 shows the development in the numbers of Pension Fund Administrators and the average level of the fee.

**Early Retirement Options**

Early retirement is possible at any time, conditional on the accumulated balance in the individual capitalization accounts meeting a specific threshold. Hence, early retirement is possible if:

- Accumulated Pension \( \geq 150\% \) of minimum pension guaranteed by the State
- Accumulated Pension \( \geq 70\% \) of average income ten years before retirement.
Payout options
There are several different options for the retiree, to structure the payout of the mandatory pensions savings:

*Life annuity:* Life Insurance Companies offer constant, lifetime monthly allowance in real terms, including survivor pension for their beneficiaries. In this case, the retiree’s resources are transferred to the insurance company, and once this contract is signed, the decision is irrevocable. Life insurance companies assume the longevity risk and financial risk in this option.

*Programmed withdraw:* The retirees maintain their individual account in the AFP, in either Fund C, D or E. The portion of the mandatory balance exceeding 70% of the average taxable wage of the last 10 years and greater than 150% of the minimum pension, can be placed in Fund A and B. The monthly payments are calculated by dividing the accumulated balance in the individual account by the necessary capital. This monthly payment is readjusted every year. In this option, the retirees assume the longevity risk and financial risk, and the AFP manages the resources.
Deferred life annuity: In this option, the member contracts a Life Insurance Company to ensure them a fixed monthly payment, starting on a date after they retire. Between the date they requested this option and the date they start to receive the life annuity, they receive monthly payments from their individual accounts. Hence, the individual only assumes the financial risk for the remaining balance in the AFP and the insurance company assumes the longevity risk.

A combination of life annuity and programmed withdraw: There is an opportunity for members who meet the conditions for retirement to use part of the balance to contract a life annuity greater or equal to the Old-Age Basic pension and keep the remaining balance in Fund C, D or E.

Figure 6 shows development in the number of persons and average pension amount in the different type of payout options.

**Figure 6: Number and Average Amount in UF for each type of Pension**

Source: www.spensiones.cl
**Pillar 3: Voluntary Saving Pillar**

This pillar contains voluntary contributions for those who wish to obtain a greater pension than the one obtained by the mandatory saving alone. Figure 7 describes the development in the number of accumulated voluntary accounts and the average balance in these accounts. The following institutions are authorized to manage **Voluntary Pension Savings (APV)** if they have their plans approved by the Superintendence of Securities,

- Pension Fund Administrators,
- Mutual Fund Administrators,
- Investment Fund Administrators,
- Housing Fund Administrators,
- General Find Administrators,
- Life Insurance Companies,
- Banks,
- Security Brokers.

*Source: Superintendence of Pension, “The Chilean Pension System”, 2010*
Summary of the Chilean Pension System

There are three different types of voluntary saving plans: Voluntary Pension Saving, Collective Voluntary Pension Savings and Voluntary Savings Accounts.

Voluntary Pension Saving
Members of AFP can voluntarily contribute a higher percentage of their wage than the mandatory 10%. The additional contribution is tax-exempt up to 50 UF (1,657 USD) and can be withdrawn at any point in time by paying a fee. If the voluntary saving is withdrawn before retirement, there is an additional tax on the withdrawal and the amount withdrawn is considered income that year, to encourage individuals to keep their savings and increase their pension. The voluntary contributions are not considered when deciding the entitlement to Solidarity Pension payments (APS).

For lower income workers that are not obligated to pay taxes, there exists an alternative tax benefit which eliminates the tax payments on withdrawals from the voluntary savings. These members will not have a tax benefit at the time contributions were made but will have the benefit at the time of withdrawal. Hence, if the member did not choose to claim tax deductions when making contributions to the voluntary pension saving, the member must only pay taxes on the yield obtained from the withdrawal of the saving.

Further, members who choose the alternative tax benefit have the right to a State bonus of 15% (with a maximum of 6 UTM each calendar year) of all voluntary savings made by the worker if he or she uses this saving to finance their pension. This bonus is added to the individual savings accounts and is used for early retirement or used to increase the pension.

Compared with the mandatory contributions, voluntary contributions may be placed in any one of the Funds managed by the AFP. Members may transfer their savings freely between the Funds in the AFP but may be charged with a commission if they transfer more than twice in one calendar year.
Collective Voluntary Pension Savings (APVC)

APVC is a saving contract between an employer (in representation of its workers) and a Pension Fund, or another institution authorized to manage these savings. The voluntary contributions made by the workers are complemented by their employer. To obtain definitive property of the contributions made by the employer, it may require the employee to remain in the company for a minimum period of time.

The contract requires a minimum of 30% of all company workers or 300 workers to subscribe at the entire period of the contract. The employer has 12 months to fulfill the minimum number or percentage if it drops below. Every worker of the employer has the opportunity to join one or more APVC contracts and all contracts must have the same terms and conditions.

The fees of these APCV contracts are agreed between the employee and the Administrator.

Voluntary Savings Accounts

This is also call a second account and is a complement to the individual’s capitalization account and is independent of all other accounts managed by the AFP. These accounts are not considered when deciding the entitlement to Solidarity Pension payments from APS. Withdrawals from these accounts are subject to income taxes.
### Appendix A

**Table 2: Limits on Structural Investments (As percentage of the value of Pension Funds)**

<table>
<thead>
<tr>
<th>INSTRUMENT</th>
<th>FUND A</th>
<th>FUND B</th>
<th>FUND C</th>
<th>FUND D</th>
<th>FUND E</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issued by the General Treasury of the Republic, Central Bank of Chile, Ministry of Housing, Recognition Bonds and Other Government Securities.</td>
<td>30%</td>
<td>40%</td>
<td>30%</td>
<td>50%</td>
<td>50%</td>
</tr>
<tr>
<td>Shared Limit: Foreign Instruments + indirect investment abroad through investment and mutual funds.</td>
<td>Maximum Limit Range: Minimum 30% VF (A + B + C + D + E); Maximum 80% VF (A + B + C + D + E)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Limit per Fund: Foreign Instruments + indirect investment through investment and mutual funds.</td>
<td>45%</td>
<td>100%</td>
<td>40%</td>
<td>30%</td>
<td>20%</td>
</tr>
<tr>
<td>Investment in foreign currency without exchange rate coverage</td>
<td>30%</td>
<td>50%</td>
<td>25%</td>
<td>40%</td>
<td>35%</td>
</tr>
<tr>
<td>Restricted Securities: Restricted ACC + [ACC+CFl+PF1] low liquidity + [CFI+CFM+CME+CIE] non-approved CCR + [DEB+BCA+ACC+ECO+OAC] less than three years + [FIN+LHF+DEB+BCA+ECO+EXT+OAC] less than BBB and N-3 or with less than 2 ratings. Superintendence of Pensions may exclude letter K instruments.</td>
<td>10%</td>
<td>20%</td>
<td>10%</td>
<td>10%</td>
<td>10%</td>
</tr>
<tr>
<td>Variable Income (maximum limit): National securities + foreign securities if they are capital + other public-offering instruments that are capital instruments under the supervision of SVS or SBIF and authorized by the Superintendence of Pensions.</td>
<td>80%</td>
<td>60%</td>
<td>40%</td>
<td>20%</td>
<td>5%</td>
</tr>
<tr>
<td>Variable Income (minimum limit): definition same as for 5.</td>
<td>40%</td>
<td>25%</td>
<td>15%</td>
<td>5%</td>
<td>---</td>
</tr>
</tbody>
</table>

*Source: Superintendence of Pension, “The Chilean Pension System”, 2010*
### Table 3: Maximum Limits on Investment by Instrument and Group of Instruments (as a percentage of the value of Pension Funds)

<table>
<thead>
<tr>
<th>Instrument</th>
<th>Maximum Limit</th>
<th>Maximum Limit</th>
<th>Maximum Limit</th>
<th>Maximum Limit</th>
<th>Maximum Limit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public and Private Company Bonds + Exchangeable Public and Private Company Bonds + Negotiable Instruments</td>
<td>60%</td>
<td>60%</td>
<td>60%</td>
<td>60%</td>
<td>60%</td>
</tr>
<tr>
<td>National and Foreign Exchangeable Public and Private Company Bonds</td>
<td>30%</td>
<td>30%</td>
<td>10%</td>
<td>10%</td>
<td>3%</td>
</tr>
<tr>
<td>Open Joint-Stock Company Shares</td>
<td>60%</td>
<td>50%</td>
<td>30%</td>
<td>15%</td>
<td>5%</td>
</tr>
<tr>
<td>Operations or contracts for loans or mutual M instruments (national)</td>
<td>15% of national portfolio</td>
<td>15% of national portfolio</td>
<td>15% of national portfolio</td>
<td>15% of national portfolio</td>
<td>15% of national portfolio</td>
</tr>
<tr>
<td>Instruments on Loan (Foreign)</td>
<td>1/3 Foreign Investment A</td>
<td>1/3 Foreign Investment B</td>
<td>1/3 Foreign Investment C</td>
<td>1/3 Foreign Investment D</td>
<td>1/3 Foreign Investment E</td>
</tr>
<tr>
<td>Restricted ACC + [ACC+CFI+PFI] low liquidity + [CFI+CFM+CME+CIE] non-approved CCR + [FIN+LHF+DEB-BCA+ECO+EXT-OAC] less than BBB and N-3 or with less than 2 ratings.</td>
<td>Same as for restricted instruments (CA line 4)</td>
<td>Same as for restricted instruments (CA line 4)</td>
<td>Same as for restricted instruments (CA line 4)</td>
<td>Same as for restricted instruments (CA line 4)</td>
<td>---</td>
</tr>
<tr>
<td>Instruments with a rating equal or less than BB and level N-4 or with less than 2 risk ratings</td>
<td>5%</td>
<td>4%</td>
<td>3%</td>
<td>2%</td>
<td>-</td>
</tr>
<tr>
<td>Contributions from promises of subscription and payment of Investment fund shares</td>
<td>2%</td>
<td>2%</td>
<td>2%</td>
<td>2%</td>
<td>2%</td>
</tr>
<tr>
<td>Foreign Capital Investment Fund (FICE) Shares</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>---</td>
</tr>
<tr>
<td>Each type of letter K) instrument</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
</tr>
</tbody>
</table>
### Summary of the Chilean Pension System

#### Table 3: (Continued)

<table>
<thead>
<tr>
<th>INSTRUMENT</th>
<th>FUND A</th>
<th>FUND B</th>
<th>FUND C</th>
<th>FUND D</th>
<th>FUND E</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total resources delivered as margins in hedge fund transactions of letter I, number II.1</td>
<td>2% National and 2% Foreign</td>
<td>2% National and 2% Foreign</td>
<td>2% National and 2% Foreign</td>
<td>2% National and 2% Foreign</td>
<td>2% National and 2% Foreign</td>
</tr>
<tr>
<td>Transactions with derivatives of letter I.2, number II.1 (investment derivatives)</td>
<td>3%</td>
<td>2%</td>
<td>2%</td>
<td>1%</td>
<td>----</td>
</tr>
<tr>
<td>Transactions with derivatives of letter I.2, number II.1 (investment derivatives)</td>
<td>Measurement of exposure: add the exposure in the asset subject to all relevant limits and subtract the corresponding “financing” of debt instruments.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment Fund Shares + Amount of contributions committed through promises of subscription and payment of Investment Fund + Mutual Fund shares</td>
<td>40%</td>
<td>30%</td>
<td>20%</td>
<td>10%</td>
<td>5%</td>
</tr>
<tr>
<td>National Mutual Fund Shares</td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
<td>5%</td>
</tr>
<tr>
<td>Overnight + Time Deposit</td>
<td>2%</td>
<td>2%</td>
<td>2%</td>
<td>2%</td>
<td>2%</td>
</tr>
<tr>
<td>Structured Notes issued by foreign institutions.</td>
<td>4%</td>
<td>3%</td>
<td>2%</td>
<td>2%</td>
<td>----</td>
</tr>
</tbody>
</table>

Source: Superintendence of Pension, “The Chilean Pension System”, 2010