Ministerio de Economía y Finanzas | Oficina de Planeamiento y Presupuesto

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MEF – OPP Communiqué: Lines of Action to Strengthen the Mandatory Individual Savings Pillar of Uruguay´s Pension System

The assessment from the Social Dialogue establishes that, notwithstanding the strengths of the current pension system, it is advisable to carry out transformations aimed at improving the functioning of the individual savings pillar of the social security system in Uruguay.

Following the release of the final document of the Social Dialogue— which contains its assessment and recommendations— the Executive Branch, through the Ministry of Economy and Finance (MEF) and the Office of Planning and Budget (OPP), initiated a working exchange with the main actors of the pension system, including the Pension Fund Administrators (AFAPs), and key financial stakeholders in the Uruguayan sovereign debt market. The objective of this exchange was to promote and implement concrete initiatives aimed at strengthening the mandatory individual savings pillar.

Based on the above, the government has established a series of lines of action to improve the mandatory individual savings pillar while preserving its current core foundations. The pension system will continue to rest on the following key pillars:

- A system organized around three pillars: non-contributory solidarity, intergenerational pay-as-you-go, and mandatory individual savings.
- Professional management of the pension savings fund by pension fund administrators, both public and private.
- Individual accounts under the capitalization pillar that are non-transferable and remain the exclusive property of each affiliate.
- Supervision and regulation of the system in line with high international standards and best practices.

Within this framework, the Executive Branch has defined the following objectives to improve and strengthen the mandatory individual capitalization pillar:

- **Improve retirement benefits for affiliates** by increasing net returns on pension savings. This will be achieved through reductions in commissions and collective insurance premiums, the gradual expansion and diversification of AFAPs´ investment portfolios, and gains in financial and operational efficiency of the AFAP.
- **Strengthen the regulatory framework** to improve competition among AFAPs and achieve more effective alignment of incentives with their affiliates, while **maintaining workers' freedom of choice to choose the AFAP**.
- **Promote greater integration of the pension system**, by better linking the intergenerational pay-as-you-go and individual capitalization pillars. This includes ensuring comprehensive and timely pension advice from both social security institutions and administrators, enabling workers to make informed decisions throughout their working lives and at retirement. **AFAPs will continue to manage individual accounts**. In addition, progress will be made toward establishing a single window to centralize retirement procedures, thereby **improving the worker's experience as a beneficiary of the pension system**.

- **Reaffirm the central role of AFAPs as key institutional investors in the capital markets**, supporting the financing of national productive investments as well as the development and deepening of the Uruguayan public debt market, particularly in local currency.

Based on these objectives, the Executive Branch has identified a set of lines of action to be developed. These initiatives aim to enhance operational efficiency in the individual savings pillar, strengthen its competitive and regulatory framework, and address pending aspects from existing laws and regulations. Once implemented together, these transformations are expected to **reduce the commissions charged by AFAPs by an estimated 5% to 10%** relative to current levels. The main lines of action are summarized below:

1. Comprehensive pension information and advice

- Promote comprehensive and timely pension advice for affiliates that effectively integrates the pay-as-you-go and individual savings pillars.
- Centralize information systems gradually under appropriate governance, with the technical support and assistance of the Agency for Electronic Government and Information and Knowledge Society (AGESIC, for its acronym in Spanish). It will apply high standards of quality, security, and interoperability to ensure equal access to relevant information for all affiliates.
- An integrated information system will enable workers to receive advice from the social security institution or from their AFAP, according to their preferences, while promoting clarity, timeliness, quality, and simplicity of information.

2. Single window for retirement procedures and greater flexibility in AFAP choice

- Advance the development of a single window that centralizes retirement procedures at the social security institution. This will avoid duplication of processes for affiliates and foster a more integrated system, while preserving the personalized advice that AFAPs will need to continue to provide to affiliates who request it.
- Promote greater flexibility in AFAP selection procedures by allowing them to be carried out either at the chosen administrator or at the social security institution, thereby improving the overall experience of workers as beneficiaries of the pension system.

3. Assignment of new affiliates to AFAPs through auction or other competitive mechanism

- Implement a competitive allocation mechanism for new affiliates entering the individual savings regime. This mechanism will reward AFAPs that offer higher net returns and lower commissions, with the latter also applying to existing affiliates. In all cases, workers will retain full freedom to subsequently choose the AFAP that will manage their individual accounts and savings funds.
- This approach strengthens competition among AFAPs as a driver for better returns and lower commissions, directly benefiting affiliates with higher expected retirement benefits. The mechanism will also aim to generate efficiency gains across the system, leading to cost reductions, while seeking to prevent excessive market concentration.

4. Redesign of the collective disability and survivor insurance and reduction of insurance premiums

- Evaluate the implementation of a centralized contracting scheme for collective pension insurance, incorporating, where conditions permit, an auction process. This will increase competition in the pension insurance market, reduce costs for affiliates, and improve expected retirement benefits from the pillar.
- The new mechanism will eliminate cost differences among affiliates, reinforcing the collective nature of disability and survivor insurance.
- These changes are expected to lower the average cost of insurance, thereby increasing the amounts credited to individual accounts and enhancing future retirement benefits.

5. Expansion and greater diversification of investment portfolios to improve retirement benefits

- Given that the greatest impact on future retirement comes from the long-term returns generated by pension savings, it is considered appropriate to promote the possibility of implementing AFAPs´ portfolios with higher expected returns and greater diversification. This will be achieved through the gradual expansion of eligible foreign assets, while maintaining strict professional regulation and supervision subject to the highest standards that characterize the current investment regime.
- Changes will be implemented gradually to ensure the proper functioning of the domestic capital market, given the important role of AFAPs in financing long-term local productive investments and the local-currency public debt markets.
- Refining the investment regime will enhance returns, better align each AFAP sub-fund's composition with its investment horizon, and balance risks and liquidity needs. Combined with the regulated use of risk-hedging instruments, this will maximize the value of affiliates' savings throughout their working lives within a controlled risk environment.

6. Reduction of commissions and greater alignment of incentives between Pension Funds and affiliates

- In addition to the expected 5% to 10% reduction in commissions mentioned above, redesign the AFAP commission structure to more effectively align the incentives of administrators with the interests of affiliates, given the goal of maximizing long-term net returns. This includes two key measures:
    - Transition to commissions based on of assets under management (instead of contributions) for affiliates who joined the system after December 2023, incorporating safeguards to address prolonged periods of unemployment. This change will improve comparability with other financial products and reduce AFAP commission revenues during the transition period.
    - Introduce a commission-setting mechanism with a fixed component, as well as a variable component directly linked to investment performance, including reductions in cases of underperformance. This variable two-way mechanism, applicable to all affiliates, would strengthen the connection between the returns achieved on individual accounts and the commissions charged by AFAPs, leading to better incentive alignment and a more balanced distribution of risks between administrators and affiliates.