



PRIVATIZING SOCIAL SECURITY: BEYOND THE THEORY

Administering Individual Accounts

By: Daniel Lederman
President, Synergy Group, Inc.



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Administering Individual Accounts

- The road to individual accounts
- How to manage cost, what the experience shows
- Processes in a system of individual accounts
- Some key differences
- Implementation is critical
- Systems in other countries
- Conclusion

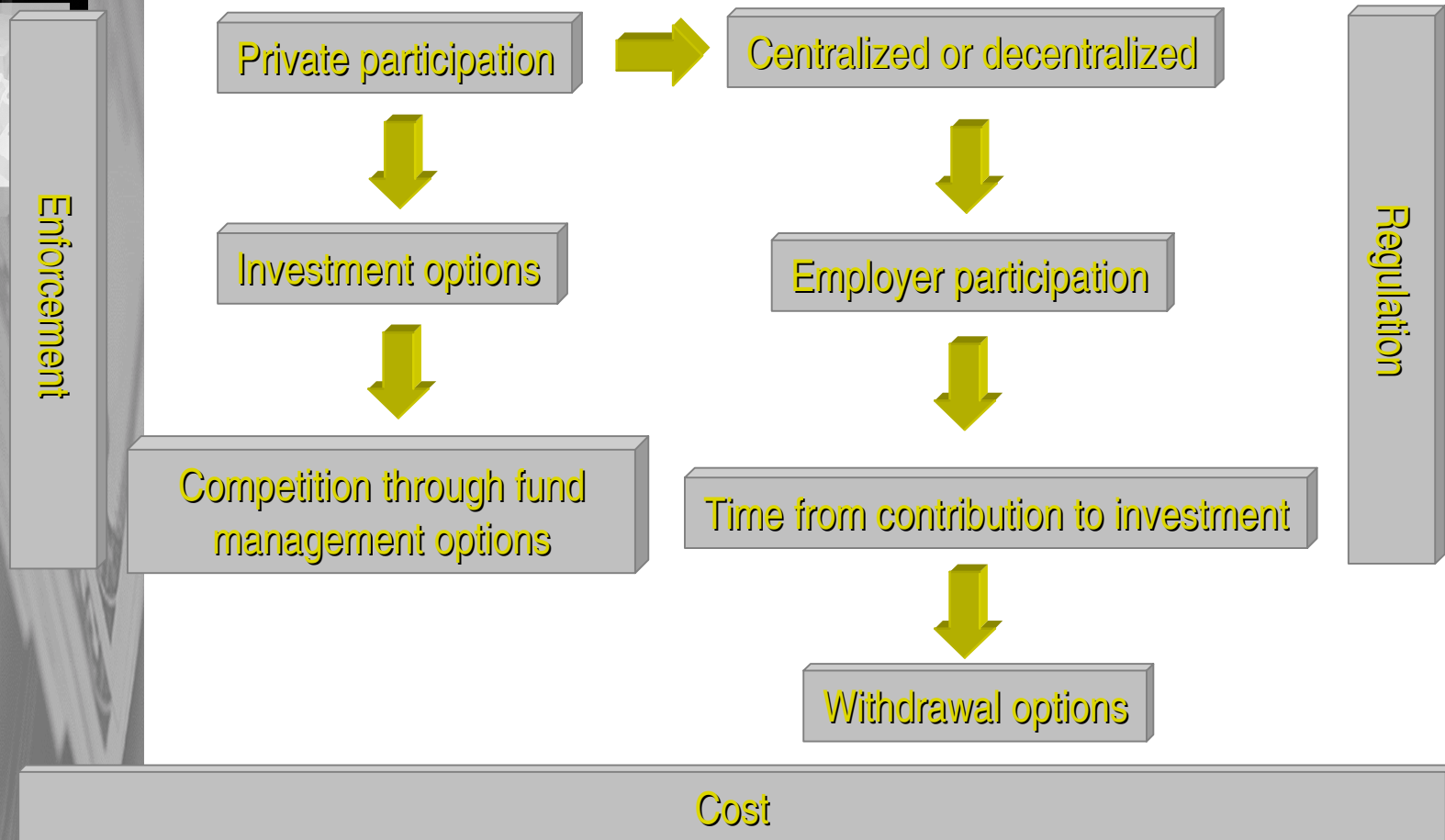


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The road to individual accounts

Administration of Social Security funds through individual accounts means different things to different people.



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Private participation

- It has to be determined the level of private participation in the system
 - Collection, Investment, Distribution, Management, Services
- Existing infrastructure and experience could be utilized to reduce cost and development time
- Private participation creates competition reducing costs and improving service
- Public institutions have to be considered
 - Enforcement, Regulation, Information



Investment options

- The system should allow participants to choose from different investment options
 - This will stress the sense of ownership
 - Will offer different products according to people's needs and profiles
- Investment options means
 - More complex enrollment procedures
 - More complex information systems
 - More complex collection procedures
 - The need for transfer mechanisms

Investment options



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Competition through fund management options

Private participation



Investment options

- Competition could be provided by allowing several fund managers to participate in this new market
- Competition in the management of funds could contribute for better returns overall
- ...but competition also requires strict regulations and supervision by the government

Competition through fund management options

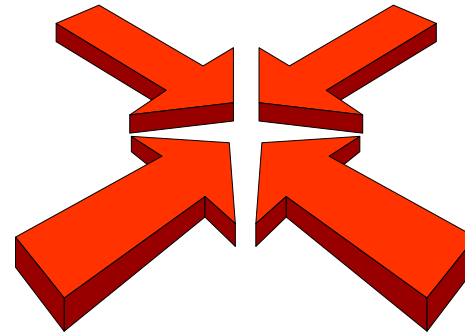
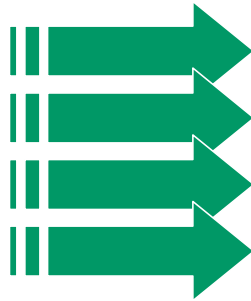


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Centralized or decentralized

- If private participation is allowed, the structure of the system operation has to be designed:
 - One central entity responsible for the collection of payments that manages one central database with all participants information
 - Several entities in a distributed network that handle the main processes



- The Social Security Administration could participate in a centralized model with the information from its databases

Centralized or decentralized



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Employer participation

- Although the system is directed to employees, the role of the employers has to be defined
- Employers are the link between the Social Security system and the participants
- Through employers some tasks could be simplified, reducing costs
- When calculating the cost of the system, the cost that employers incur has to be considered



Time from contribution to investment

- A system of individual accounts has to consider the perception and expectations of its participants
- A key decision has to be made on the time allowed for the contributions to reach the individual accounts
- Currently it takes between 7 and 22 months to close this loop
- In a system of individual accounts there could be implications that have to be considered:
 - Financial implications
 - Confidence implications

Time from contribution to investment



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Withdrawal options

- One key question for the system is the mechanism allowed for withdrawals
 - Annuities
 - Lump sum
 - Programmed withdrawals
- The institutions involved in the process and their responsibilities have to be defined
 - Who certifies eligibility
 - Who calculates amounts
 - Who pays



Regulation

- In designing the regulatory framework for the system, all different perspectives have to be considered
 - Labor
 - Social
 - Economic
 - Financial
- It has to be determined which agency will be responsible for the regulation
 - In Chile is an independent agency related to the Ministry of Labor
 - In Mexico it is related to the Ministry of Finance



Enforcement

- Enforcement in most systems is left to the government
- In some systems, like Chile, enforcement is the responsibility of the private fund managers
- The information requirements of agencies responsible for enforcement, have to be considered

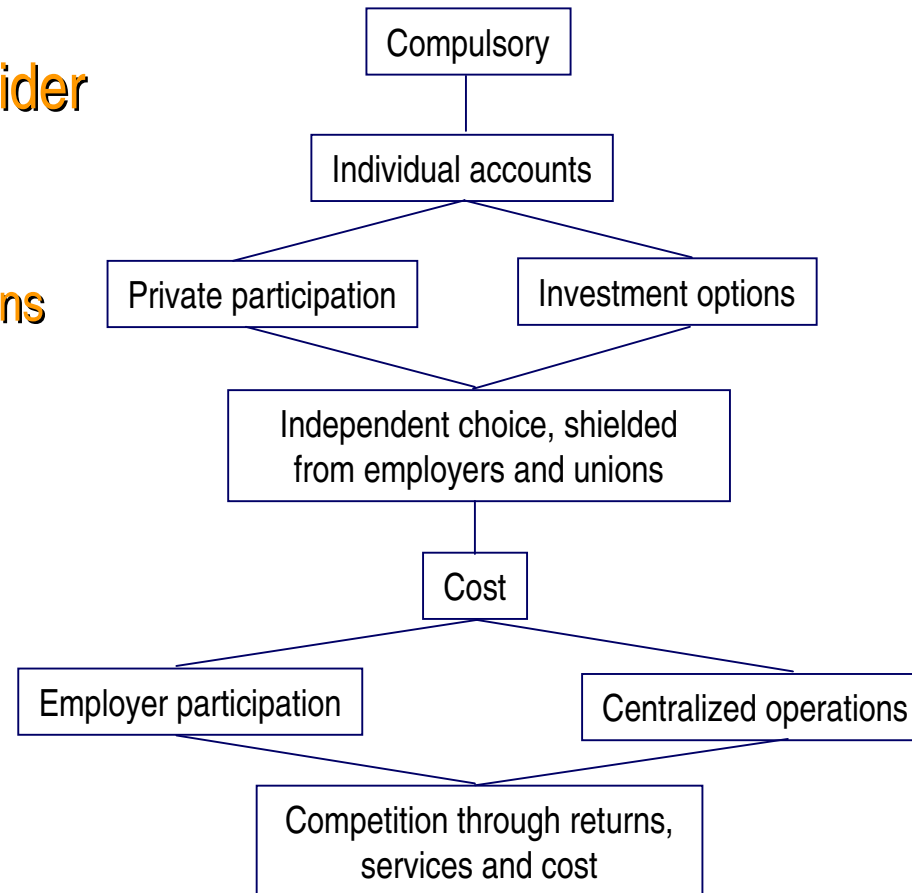


Costs

- A decision tree could be design to determine when the Cost variable becomes important and when is independent of other considerations

- Costs have to consider

- Employers
- Participants
- Managing institutions
- Regulators



Decision tree for the Mexican System



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Costs

How to manage cost, what the experience shows

- Marketing and distribution
 - Has shown to be an important component of the cost
- Bring in private institutions and provide incentives for their participation
 - Regulate through existing channels (SEC, etc.)
 - Limit the number of contributions per year to 12 or less
 - Extensive use of electronic reporting from employers
 - Participation by Social Security with its information systems



Processes in a system of individual accounts

- Enrollment
- Collection
- Distribution
- Investment
- Statements
- Withdrawals
- Transfers



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Implementation is critical

- After the key decisions have been made is important to carefully design the implementation plan
 - Information systems
 - Software
 - Hardware
 - Processes
 - Databases
 - Networks
- Experience shows that more time is given to the political debate than to the implementation process



World examples

These countries have pension systems managed through individual accounts. Each took a different approach:

	Private participation	Investment options	Competition	Centralized	Employer participation	Time to investment	Withdrawal
Chile	Independent financial institutions	Recently opened for a second fund	Price, services	Decentralized	Contributions	Less than 72hrs	Annuity or programmed withdrawals, choice of provider
U.K. (optional personal pensions)	Wide range of financial institutions	Wide range of options	Available but restricted by conditions	Centralized collection	Contributions, some decision on provider (optional for worker)	Up to 24 months	Lump sum limited, Annuity, choice of provider
Mexico	Independent financial institutions	Allowed not implemented	Price, returns, services	Centralized operations	Limited through contributions	5 business days	Annuity or programmed withdrawals, choice of provider
Australia	Large number of providers	Limited	Directed to employer decisions	Decentralized	Employer decide on plan and provider	Days	Lump sum or Annuity, choice of provider

Conclusion

- Determine the priorities and true objectives of the individual account system in the U.S.
- Answer the key questions
- Design a system based on the established principles
 - Search for alternatives with lowest cost
 - Design a thorough implementation plan
 - Offer enough time for implementation

