

IESS: risk of decapitalization and possible corrective measures

The IESS is the main pillar of the Ecuadorian Social Security System. It offers a variety of assistance services to its affiliates, including disability, health care, labor risks and rural social insurance coverage to more than 60% of the country's population.

In recent years, the financial situation of this Institution has deteriorated notably. There have been many legal reforms that have negatively affected the general condition of the IESS due to bad governmental decisions without the necessary technical and actuarial support. Furthermore, some politicians are confusing liquidity with solvency for PAYG systems.

Consequently, this past September, I presented the article "IESS: Risk of Decapitalization and Possible Corrective Measures" about the financial situation of the IESS, which was published in one of the most important newspapers in the country.

This article analyzes the present and future situation of the Ecuadorian Institute of Social Security (IESS), recommending possible actions that would guarantee a correct functioning and sustainability of the system.

Of the four insurance funds managed by the Social Security, there is no doubt that the Pension Fund and the Health Insurance Fund represent the greatest concentration of resources in the system and the greatest collective challenge.

In recent years, there have been many legal reforms that have negatively affected the general situation of the IESS due to governmental decisions without the necessary technical and actuarial support. The reforms with the highest negative impact are the following:

1. In 2010, the reform of the Social Security Law was published. Article 5 establishes that disability, retirement and Occupational Risk Insurance pensions will increase annually as of January of each year, based on a specific table, causing an imbalance in this Fund.
2. In April 2015, homemakers were included in the coverage of the IESS for housewives who do not receive any kind of monetary remuneration. This inclusion was made without the needed financial support.
3. In the same Law of April 20, 2015, the historic 40% of the State's contribution for the payment of pensions was eliminated, without replacing its financing.

4. On November 13, 2015, the Directing Council of the IESS, established a temporary reduction in contributions to the Pension Fund from 9.74% to 5.86% and an increase in the health contribution from 5.71% to 9.94% to cover the deficit in health.

Financial Situation of the IESS Pension Fund

In a recent actuarial analysis, the Pension Fund presented the following results:

With the elimination of the State's contribution of 40% for the payment of pensions and the temporary reduction of the contribution rate, the Pension Fund will present an actuarial deficit of US\$ 139 billion, apex. 140% of the current GDP.

The decapitalization of this fund will occur in an estimated period of 5 years if the necessary measures are not taken to stabilize its financial situation.

For 2017, the projected income of the Pension Fund is of approximately US\$ 1.7 billion, representing less than half of the total amount needed for the payment of benefits this year (US\$ 3.6 billion). This represents a financing gap of approximately US\$ 1.9 billion dollars for 2017. This gap is projected to grow even further in future years, reaching US\$ 2.4 billion in 2025 and US\$ 42 billion in 2055.

Due to the projected increase in the number of pensioners combined with a smaller percentage increase in the number of contributors, it is estimated that the pension support rate will decrease from currently 7 to 3.80 by 2055.

Recommendations and Conclusions

- Based on national and international experience and considering the instability and vulnerability of the Ecuadorian Social Security System, the following measures are recommended for stabilization:
- Carry out actuarial and financial studies that analyze the reality of the demographic, economic and social characteristics of the participants of the system, to identify the current shortcomings and take corrective measures that allow the strengthening of the funds.
- Propose a new Social Security Law where structural and parametric reforms are recognized to reestablish the financing methods and feasibility of all benefits.
- Implement a strict regulation that avoids modifications to coverages or initial parameters without prior technical analysis and whose nonobservance should be penalized.
- Discuss in a technical way the need to reform the current system. One possibility is the creation of a hybrid or mixed system with two components: a common fund and a defined contribution system based on a portion of the contributions made by each member, which was already proposed for in the 2001 law, but was never put into practice.
- Establish investment policies, especially in the long term, to prevent resources from being used for other purposes.
- The importance of carrying out independent and up-to-date actuarial and financial studies that analyze the reality of the IESS should always be emphasized in order to ensure the sustainability of the system over time and in turn, the future of millions of Ecuadorians. It is

not that finances must prevail over human beings, but poorly managed finances end up seriously affecting those very people who are intended to protect.