



## PENSION NOTES

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### PENSION FUND WITHDRAWALS DUE TO COVID-19

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#### INTRODUCTION

Considering the duration of the pandemic and its significant impact on workers' incomes, Peru and more recently Chile, have allowed members to withdraw part of their pension savings. In the other Latin American countries with individually-funded pension systems, with the sole exception of Uruguay, there have been parliamentary initiatives to allow workers to withdraw part of their pension savings. Likewise, the partial withdrawal of Pension Funds in mandatory or voluntary funded systems has been allowed in other parts of the world, such as Australia, the United States, India and Iceland. Given this reality, it is deemed important to analyze this alternative and its impacts.

#### THE ARGUMENTS AGAINST ALLOWING THE WITHDRAWAL OF PENSION FUNDS:

The main reason is that pension savings have a sole, exclusive purpose, namely to protect workers and their families with economic resources (pensions) when they stop working (retire). Using these savings for other purposes, however laudable they may be, as in this case, entails an infringement of the purpose for which they were established. One must bear in mind that pension systems worldwide have a mandatory component, since due to the existence of

a behavioral bias towards present consumption, most people would not save, or would save significantly less than necessary to ensure financial well-being in their old age.

Another reason that makes the early withdrawal of funds inadvisable is that it will further deteriorate the outlook for workers' pensions, since people were already living progressively longer in many countries of the region before these types of reforms, constantly rotating between the formal and informal markets (leading to long periods without contributions), with insufficient regulatory contribution rates (half of the rates of the OECD countries). Thus, there were many warning signs in the reality of these countries that pension savings were insufficient. Hence, the withdrawal of funds will only further aggravate this situation. Furthermore, the approval of the early withdrawal of 10% of the pension funds by the Chilean Congress is contradictory, since a law that increases contributions by six percentage points, aimed at increasing pensions, was simultaneously being processed.

If we analyze the cases in which the withdrawal of funds due to Covid-19 was authorized, 25% of pension funds in Peru and 10% in Chile, there is a minimum withdrawal amount in both cases, which may imply that the total amount effectively withdrawn could be higher

than the aforementioned percentage, or even the total amount of accumulated savings, with a consequent greater impact on the reduction of pensions, or even their entire loss. A maximum amount is contemplated in both countries, which means that for older, higher income workers, the amount effectively withdrawn would be a lower percentage than previously indicated, with a consequent lower percentage reduction in the value of their pensions. Thus, and because withdrawals in Chile are tax-free, which benefits members with higher incomes by up to 40% (with no benefit for low income members), some consider the early withdrawal of pension funds to be regressive, since it gives rise to a relatively greater reduction in the pension amounts<sup>1</sup> of lower income individuals.

Table 1 shows the distribution of Chilean workers according to the requested withdrawal amount (as of August 18, latest information published by the Pensions Commission). It can be seen that of the total universe of people who requested withdrawal, 19.5% had a balance of less than 35 UF (approx. USD 1,322)<sup>2</sup>, and therefore withdrew 100% of

their balances, significantly impacting the amount of their future pensions. Those with a savings balance of between 35 and 350 UF (between approx. USD 1,322 and USD 13,220), accounting for 45.7% of all those who withdrew, will effectively end up withdrawing a maximum amount of money greater than 10% of their fund, affecting them comparatively more than those who have balances between 350 and 1500 UF (between approx. USD 13,220 and USD 56,656: in this case the maximum cash amount they can withdraw is 10% of their fund) and those with balances greater than 1500 UF (USD 56,656) will be able to withdraw a maximum amount that is less than 10% of their balance). It is worth mentioning that these figures will change over time, since there is a period of one year for workers to request their retirement. According to the Superintendency of Pensions's balance to August 25, a total of 9.3 million Chileans requested the withdrawal of funds from their mandatory individually funded accounts, equivalent to 85% of the total number of members of the pension system. Of that total, 86% have received the requested resources, which exceed USD 10,842 million.

**Table 1**  
**Chile - No. of people, according to requested withdrawal amount**  
**To August 18, 2020**

Balance and withdrawal amount		People	
Balance in AFP	Withdrawal bracket	Number	%
Less than 35 UF	100% balance	1,684,257	19.5%
Between 35-350 UF	35 UF: >10% balance	3,941,903	45.7%
Between 35-1500 UF	10% balance	2,480,664	28.7%
More than 1500 UF	150 UF: < 10% balance	481,725	5.6%
Unknown balance		44,569	0.5%
Total		8,633,118	100%

Source: database provided by the AFPs pursuant to Law 21.248

<sup>1</sup> It is worth mentioning that this is not necessarily true in Chile, since low income members who withdraw funds and meet the conditions of the solidarity pension system will see an increase in

the SPC (Solidarity Pension Contribution) they receive from the State.

<sup>2</sup> The observed dollar exchange rate of 759 on 07/30/ was used.

In Peru, due to the Covid-19 contingency, a total of 4.95 million members (65% of the total) withdrew funds from their individually funded accounts by July 31 (latest information available), for a total amount of PEN 24,264 million (approx. USD 6,870 million)<sup>3</sup>.

workers who actually contribute (on average, only 36% of the EAP in the region; the remaining 64% are in the informal sector and the majority do not contribute).

Another relevant aspect is that the early withdrawal of pension funds is not focused on the workers who most require help due to the loss of income, since a smaller percentage of the pension funds belong to informal workers, who are those who have been hardest hit in their income by the pandemic. This is a serious problem in Latin American countries, in which informal employment is mostly predominant, as can be seen in Table 2. Hence, there is a very low percentage of

**Table 2 (AFP/EAP contributors)**

<b>Country</b>	<b>Contributors (1)</b>	<b>EAP (***) (2)</b>	<b>(1)/(2)</b>
Chile	5,609,357	9,157,728	61.30%
Colombia	6,497,534	25,159,804	25.80%
Costa Rica	1,139,247	2,492,283	45.70%
El Salvador	734,419	3,004,990	24.40%
Mexico (*)	19,999,701	57,625,521	34.70%
Peru (**)	2,837,927	17,462,800	16.30%
Dominican Rep.	1,813,515	5,008,937	36.20%
Uruguay	835,748	1,803,064	46.40%
<b>Weighted average</b>			<b>36.13%</b>

(\*) Mexico: Contributors' Data to December 2019.

(\*\*) Peru: Contributors' Data to February 2020.

(\*\*\*) Economically Active Population (EAP): 2019 or latest information available. Local sources of information in each country are used.

Source: FIAP.

<sup>3</sup> These figures account for up to 25% of the funds, including the withdrawal of up to PEN 2,000 by members who were fully unemployed as a result of the pandemic.

Due to the above, many specialists were not surprised by the fact that the sales of TVs and other electronic items, and even automobiles, grew strongly in Chile when the early withdrawal of funds was approved, confirming the lack of means testing of the measure.

Last but not least, there is the fear that once the door to the early withdrawal of funds has been opened for the first time, for a truly extraordinary cause, closing it may be subsequently impossible and new withdrawals may be authorized for different reasons, defeating the purpose of pension savings, or even eliminating them. One need only analyze the Peruvian experience in this regard, where 2 Laws (30.425 and 31.077) and 3 Emergency Decrees (033, 034 and 038) have authorized the early withdrawal of pension funds for various purposes, or temporarily suspended the obligation to contribute to the AFPs, in the last five years.

It seems that the political dividends associated with allowing the early withdrawal of Pension Funds are significant, and this would explain the number of laws and regulations that make it possible, to the detriment of the economic

#### **OTHER CONSIDERATIONS:**

An initial aspect to consider is that the early withdrawal of pension funds due to Covid-19 is possible only in individually funded systems, since the PAYGO systems do not have significant accumulated reserves. In fact, if the amounts collected by PAYGO systems from workers' contributions were to be distributed among the workers themselves, current pensioners would be left without pensions.

situation of future pensioners, perhaps because this is only a problem in the mid and long term. In Chile, a group of Deputies recently submitted a bill of law to authorize a second withdrawal of funds, following the example of Peru.

There are other arguments against allowing the early withdrawal of funds, such as:

- (i) The negative effect on the fiscal budget, due to an increase in the expenditure of the solidarity pension system and/or minimum or welfare pensions;
- (ii) Increase in the cost of disability and survival insurance, due to lower balances in individual accounts;
- (iii) A significant percentage of members would exhaust the funds in their accounts, which would increase the political risks of reforms, because they would affect only a part of the population (the others would no longer have any savings);
- (iv) Effects of the lower volume of funds on the capital, savings and investment markets, and GDP growth;
- (v) Transitory impact on the investment structures of pension funds.

In Peru, the Individually-Funded System competes with a PAYGO system (Sistema Nacional de Pensiones - SNP), and in response to accusations of discrimination, since only AFP members have access to Covid-19 withdrawals, the head of the Pension Standardization Office (ONP) stated some time ago that this agency's PAYGO system would make it "unviable" to reimburse funds to those

who contributed for less than 20 years<sup>4</sup>. The Ministry of Economy and Finance, in turn, has opposed the bill of law that would allow the withdrawal of contributions to the SNP, since it would be impossible to return money that does not exist to users (because contributions are used to pay current pensions in PAYGO systems)<sup>5</sup>. Despite the opinion of the authorities and the government, on August 25, the Peruvian Congress approved the withdrawal of up to PEN 4,300 (approx. USD 1,185) of contributions to the SNP. The bill of law also gives the green light for a group of members to be able to access all of their contributions (those who at age 65 or more have not met the requirements for accessing a pension, i.e., 20 years of contributions)<sup>6</sup>.

Should this initiative be successful, the payment of pensions would be at serious risk, since additional financing from the Public Treasury would be required. In this scenario, one of the first to speak out against the bill of law was the Chairman of the Council of Ministers, who announced that the Peruvian Government would not support the regulations approved in Congress. The Ministry of Development and Social Inclusion also opposed the decisions of Congress, pointing out that the reimbursement of SNP contributions would affect the Executive's ability to operate non-contributory social programs, such as, for example, Pension 65.

Ultimately, the existence of property rights on accumulated savings in individually funded systems, opens up the possibility of withdrawing part of the funds in case of emergency, which is one of the advantages of these systems.

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<sup>4</sup> <https://gestion.pe/economia/onp-inviable-devolucion-quienes-aportaron-20-anos-245342-noticia/?ref=gesr>

<sup>5</sup> <https://gestion.pe/economia/mef-mef-tras-aprobacion-de-retiro-de-aportes-a-la-onp-no-es-posible-devolver-plata-que-no-existe-nndc->

The experience acquired in this pandemic shows us how important it is for countries to implement systems protect workers' incomes against the most meaningful contingencies they may face, such as unemployment insurance and other schemes for financing other needs (housing, education, illness, etc.), which can initially be used by workers in these cases, or in a general emergency, such as this one.

In the absence of these protection systems, the State must support the neediest workers. The difficulty, apart from the significant amount of resources required, seems to lie in means testing, since it is not easy to identify and effectively reach out to help these workers and their families, since most of them obtain their income from informal jobs. Governments must make greater efforts to have reliable information to know who to benefit (many times there are complaints from people who do not receive assistance, and others who receive assistance without really needing it). Likewise, the State must carry out a vigorous campaign for disseminating the benefits it is granting, and how they can be accessed, in a language that is understandable to the population it seeks to reach.

A final consideration regarding early withdrawals of pension funds is the positive impact they have had on the image of the AFPs and the individually funded system. A regular survey conducted by CADEM in Chile, showed that the percentage of respondents who trust the AFPs has recently doubled. Likewise, a survey by another specialized company, CRITERIA, shows a significant increase in the rejection of the nationalization (expropriation)

<sup>6</sup> <https://elcomercio.pe/respuestas/quien/retiro-onp-segun-lo-aprobado-en-el-congreso-quienes-pueden-acceder-al-100-de-sus-aportes-onp-oficina-de-normalizacion-previsional-sistema-nacional-de-pensiones-decreto-ley-19990-congreso-de-la-republica-revtli-noticia/?ref=ecr>

of the Pension Funds (from 52% in July to 63% in August), an increase in the awareness that the pension funds belong to workers (from 59% to 70%) and a marked reduction in the idea that part of the increased contribution (which is currently being studied in Congress) should be destined to a collective savings fund (from 42% to 31%), with 83% of those surveyed being of the opinion that pensions should be financed through individual pension savings, plus state aid.

Despite the improvement in the image of the pension system, which can be attributed, among other aspects, to a greater understanding of the system, approval of the efficient operation of the Pension Fund Managers in the massive delivery of the funds, and the realization that the funds are effectively the property of the workers, as FIAP we reiterate the inconvenience of a measure which, to resolve a short-term problem, ends up seriously affecting the purpose of these savings, which is to finance pensions. The Pension Fund Managers are committed to the solvency and proper functioning of the system. Hence, although the withdrawal has circumstantially improved their image, the Fund Managers reiterate their rejection of these types of measures. The Pension Fund Managers are most certainly interested in improving their image, but through adequately fulfilling the purpose for which the system was created.

#### **CONCLUSIONS:**

Based on the above, it is evident that although pension fund withdrawal can provide short-term financial relief, there are a number of reasons that make it unadvisable:

- Pension savings have a sole purpose, namely to protect workers and their

families with financial resources during old age, a period of greater economic vulnerability in life. Using these savings for other purposes, however laudable they may be, as in this case, entails an infringement of the purpose for which they were established.

- The countries of the region already show serious weaknesses in the generation of pension savings. This is mainly due to population aging, high levels of informality and low contribution rates. The withdrawal of funds, in this case, would only aggravate a problem that already existed, i.e., low pension amounts.
- The effect on pension amounts will be proportionally greater in lower-income workers, so this would be a regressive policy.
- Added to all of the above, is the possibility that opening the door to the early withdrawal of funds for the first time, for an extraordinary cause, could lead to a series of withdrawals that could end with the destruction of all pension savings, as is happening in Peru.

This is why pension savings should not be considered an alternative for obtaining funds in the short term, and if their withdrawal were to be considered in an exceptional situation, it should be only as a last resort, as suggested by organizations like the OECD. Furthermore, withdrawals must be limited and means tested to reach the people who really need them. Likewise, the withdrawal must be subject to clear and explicit mechanisms for recovering the withdrawn funds.

