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FIAP STATEMENT

THE EARLY WITHDRAWAL OF FUNDS AGGRAVATES THE PENSION PROBLEM AND AFFECTS THE NEEDIEST THROUGH HIGHER INFLATION AND INTEREST RATES

April 2022

For several decades, the individually funded pension systems have demonstrated sustainability, as well as their contribution to the development of capital markets and the growth of the countries in which they operate.

We are facing the challenge of considerably increasing savings to improve pensions, given the increases in life expectancy and the drop in interest rates, and especially to compensate for the high levels of informality prevailing in the region (56% of the workforce on average).

Rather than facing that challenge, many of our member countries are exploring a return to PAYGO systems, whose lack of sustainability has led countries with such systems to increasingly incorporate individually funded systems. In fact, from 1999 to date, countries with individually funded systems have tripled, from 17 to 46.

In other words, not only has the urgent need for increasing savings been ignored (with the sole exception of Mexico), but some countries, such as Chile and Peru, have promoted the depletion of savings through successive early withdrawals of pension funds.

About USD 18 billion of pension funds were withdrawn in the 5 withdrawals approved in Peru between 2020 and 2021 (equivalent to 37% of total funds prior to the withdrawals, and 8.1% of GDP), leaving 2.3 million members with zero balances in their accounts. Regrettably, despite these negative effects, the Congressional Economics Commission recently approved another early withdrawal of 4 Tax Units (approx. USD 4,973) for all members of the individually funded system, without any means testing of those who really need it. It is estimated that this new withdrawal will leave 5 million workers, 60% of members, with zero balance in their accounts. Pension savings would also be reduced by about USD 7.4 billion, with an overall loss of USD 25.2 billion (10.7% of GDP).

In Chile, on the other hand, the 3 withdrawals approved to date entailed the depletion of USD 52 billion in pension funds (equivalent to 30% of total funds prior to the withdrawals, and 18.4% of GDP), an estimated average drop in pension amounts of 30%, and about 4 million people left with zero balance in their accounts. Fortunately, the Chilean Congress rejected the fourth and fifth early withdrawals of pension funds. If a new withdrawal of up to 10 per cent of the funds had been approved, pensions would have dropped by an average of 40 per cent, and 5.8 million people would have been left with zero balances in their accounts.

As on previous occasions, the International Federation of AFPs (FIAP) wishes to point out that early withdrawals should always be the last option. Institutions such as the OECD and countless other bodies and experts have recommended that these funds should not be used for purposes other than pensions and only in case of emergencies, and that they should meet three requirements to minimize damages:

- First, means testing, i.e., making it available only to those who urgently need it.
- Second, tax neutrality, i.e., withdrawals must not be associated with any tax benefit, so as not to encourage them.
- And third, replenishment, which entails mechanisms for returning the money withdrawn, so as not to affect pensions.

Chile and Peru are among the few countries in the world where, in general, none of the above requirements have been met.

It is also worth reiterating that since the approved withdrawals have left a large number of people with zero balance in their accounts, the proposed new withdrawals will have an impact on an increasingly smaller number of people, thus neglecting the most unprotected.

Withdrawals negatively and directly impact the conditions of thousands of low-income workers, as follows:

1. **Higher inflation**: Higher inflation has a significant impact on prices, which is highly regressive since it has a proportionately harsher effect on the budget of the poorest families. The effects on inflation are considerable. In fact, the Chairman of the Chilean Central Bank and the Minister of Finance have pointed out that if a new withdrawal had been approved, inflation could have increased by up to 5 percentage points, from the current 9.5% to 14.5%.

2. **An increase in all types of loans**: The withdrawals have had a significant impact on local capital markets in Chile and Peru, due to the forced liquidations of a large volume of assets, also resulting in higher interest rates for all terms and types of loans.

3. **Less access to housing**: This is because the withdrawals have negatively affected the mortgage market. First, there is a higher financing cost (the interest rate in Chile increased by almost 1.7 percentage points). Second, there is a shorter loan repayment term (30 to 15 years in Chile). Third, higher income is required to access mortgage loans. And fourth, a higher down payment is required to access them (in Chile, it rose from 20% to 30% of the value of the property). All of this limits access to housing for thousands of families.

4. **Increased tax burden, which can reduce the funds available for financing social programs**: Pension fund withdrawals give rise to greater government expenditure in non-contributory or solidarity pensions, which, together with the increase in the interest rate, which also affects the servicing of the public debt, reduces the funds available for financing social programs that assist the most vulnerable.

A new “limited” pension fund withdrawal, mainly for the payment of debts, such as the one recently proposed by the Chilean government and fortunately rejected by Congress, is still a bad idea, because the main casualty of such withdrawals would still be the worker's self-financed pension, compromising the social security purpose of pension funds and undermining the legitimate demand for better pensions. Furthermore, the fact that the withdrawal is limited to the payment of debts may mitigate its inflationary effect, but not eliminate it.

Finally, the ongoing withdrawal of funds has broken the virtuous circle that the individually funded system created in the economy. Different studies show that the accumulation of pension funds in the individually funded systems of our member countries contributed to a higher annual growth of GDP of between 6% and 22% via the impact on the capital market, the labor market, savings, and productivity. Enhanced growth, in turn, led to a greater increase in employment and real wages and thus to higher contributions to individual accounts.

In conclusion, withdrawals without any means testing, even if limited, deplete savings and not only exacerbate the problem of workers' pensions, but also destabilize the economies of the countries that implement them, increasing inflation and putting the neediest in a worse situation.

FIAP firmly believes that the pension reform discussion should be based on viable and sustainable options. It is not wise to maintain or revert to PAYGO systems in response to major demographic challenges, let alone to promote the depletion of savings when the major challenge is to promote savings. This process must be accompanied by strong institutions and committed governments, to prevent fiscal pressures and short-term political convenience and the implementation of populist reforms that destroy savings, undermining the pension system and affecting the future well-being of the population.

We urge the authorities to desist from these ongoing withdrawals of pension savings that are doing so much damage to workers and their families, and to adopt public policies focused on improving their pensions, sustainable in the long term, that enable the achievement of the principal purpose of any pension system, which is to reduce poverty in old age and provide sufficient pension amounts that replace a reasonable percentage of the income received while active, with pension options that enable a stable income flow in retirement.

Signed by: The Board of Directors of the International Federation of Pension Fund Administrators, FIAP.

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