FIAP STATEMENT
EARLY PENSION FUND WITHDRAWALS AGGRAVATE THE LOW PENSIONS PROBLEM AND IMPAIR THE PROSPERITY OF WORKERS AND ECONOMIES

April 2024

For several decades, the individually funded pension systems have proven to be sustainable and have contributed to the development of capital markets and the growth of the countries where they have been implemented.

We are facing the challenge of actively increasing savings to improve pensions, in view of increases in life expectancy and the drop in interest rates, and especially to compensate for the high levels of informality in the region (44% of the workforce on average).

Instead of taking up the gauntlet, many of our member countries are exploring a return to the PAYGO systems, which have led countries with these systems to increasingly incorporate savings mechanisms in their different modalities, due to their unsustainability. In fact, countries that have adopted such mechanisms have tripled from 1999 to date, from 17 to 51.

I.e., in the Latin American region, not only has the urgent need to increase pension savings been ignored (with the sole exception of Mexico, which recently approved increases in its contribution rate), but some countries, such as Chile and Peru, have promoted the depletion of savings through successive early withdrawals of pension funds.

On the one hand, six withdrawals were authorized in Peru, between 2020 and 2022, amounting to a total of approx. US$ 23,524 million[1] (51% of the total value of the funds at the beginning of the pandemic, and 9% of GDP). It is worth mentioning that the first 2 of the 6 withdrawals were authorized by the Executive and were of an exceptional, means-tested, and very limited nature (altogether US$1,337 million), unlike the following four authorized by Congress, with no means-testing, for approx. US$ 22,187 million. After these six withdrawals, a total of 2 million enrolled members with individually funded accounts with zero balance (mostly lower income individuals) were recorded. Unfortunately, on March 25, the Economic Commission of the Peruvian Congress gave the green light to authorize this seventh withdrawal of workers' funds, for an amount of up to 4 UIT[2] (approx.

[1] The following US Dollar (US$) / Peruvian pesos (PEN) exchange rate on April 4, 2024, was used in this document: 1 US$1= PEN 3.74089.

[2] Unidad Impositiva Tributaria (Tax Unit).The value of the UIT for the year 2024 is PEN 5,150.

US$ 5,507) for all enrolled members, without exception. This new non-means-tested withdrawal would generate a potential outflow of resources of approx. US$9,089 million (equivalent to 27% of all existing funds), with a total outflow of about US$32,639 million (about 14% of GDP) including the five previous withdrawals. It is estimated that 7 million workers (75% of enrolled members) will be left with zero balance in their accounts, and therefore without resources for accessing a contributory old-age pension. This withdrawal will, in turn, generate a greater financial burden for the State and increase the cost of borrowing, due to the immediate sale of sovereign bonds (19% of the funds of the AFP system are invested in central government instruments), raising the cost of loans for all Peruvians.

The analyses performed show that this new Peruvian withdrawal mainly favors higher income members with job security: at least 75% of the withdrawn amount would be for enrolled members with regular contributions who have not experienced a meaningful interruption of labor income. Furthermore, 50% of any potential new withdrawal would go to enrolled members in the highest labor income quintile. Hence, the measure is regressive, since the lower income segments of the population, and the most vulnerable, no longer have funds in their individual accounts as a result of the five previous withdrawals. Likewise, 75% of the funds would be withdrawn by members over 40 years of age, leaving them at greater risk of lack of protection due to fewer options of being able to access a pension at retirement age.

In Chile, on the other hand, the 3 pension fund withdrawals approved to date amounted to about US$ 50 billion (equivalent to 23% of the total funds prior to the withdrawals, and 16% of GDP), leaving about 4 million people with zero balance. Fortunately, the Chilean Congress rejected the fourth and fifth early withdrawals of pension funds. If another withdrawal of up to 10% of the funds had been approved, pensions would have fallen by 40% on average, and 5.8 million people would have been left with zero balance in their accounts.

The International Federation of Pension Fund Administrators (FIAP) would like to point out, as on previous occasions, that early withdrawals of funds should always be the last option. Institutions such as the OECD and countless other agencies and experts have recommended that these funds should not be used for purposes other than pensions, and in case of emergency they must meet three requirements to minimize damage:

- First, means-testing, i.e., authorizing withdrawals only for those who urgently need them.
- Second, tax neutrality, i.e., withdrawal must not be associated with any tax benefit so as not to encourage them.
- And thirdly, replacement, which means seeking ways of returning the money withdrawn, and thus not affecting pensions.

Chile and Peru are among the few countries in the world where almost none of the above requirements were 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.

These withdrawals directly and negatively impact the conditions of thousands of low-income workers, in the following ways:

1. **Higher inflation**. This higher inflation has a significant impact on prices, which is severely regressive since it causes higher proportional impairment to the budget of the poorest families. In Chile, for example, accumulated inflation since the first authorization of these withdrawals is 28.6%; during the withdrawal cycle, liquidity was equivalent to 18% of the country's GDP injected into households, i.e., more than US$ 53 billion, which led to overspending; by August 2022, prices had risen by 14.1%, in annual terms, something unheard of in three decades in the country, forcing the Central Bank to tighten its monetary policy, which it has only relaxed in recent years. The consequences have been clear: much higher borrowing costs and a brake on economic activity.

2. **Labor market deterioration**. The withdrawals led to an artificial boom that ended up slowing economies and contributing to the deterioration of the labor market. In Chile, for example, there has been no improvement in the situation of workers. In fact, according to the National Institute of Statistics (INE), the unemployment rate in the November 2023-January 2024 quarter was 8.4%, well above the 7.4% of the same period in 2020, and even more than the 6.8% of the same period in 2019.

3. **More expensive loans of all types**. The withdrawals had a significant impact on the local capital markets in Chile and Peru, due to the forced liquidation of a large volume of assets, which has also driven higher interest rates for all terms and types of loans.

4. **Reduced access to housing**. This is because the withdrawals impaired the mortgage market. First, there is a higher financial cost (the interest rate in Chile increased by almost 1.7 percentage points). Second, there is a shorter loan repayment term (from 30 to 15 years in Chile). Third, higher income is required to access mortgage loans. And fourth, higher down payments are now required to access them (from 20% to 30% of the value of the property, in Chile). All of this limits access to housing for thousands of families.

5. **A greater financial burden on society**, because it will have to provide the resources (via taxes or other means of collection) and/or immediate family, who will have to finance the protection of family members who withdrew their funds.

6. **Increased fiscal pressure, which may reduce resources for financing social programs**. Pension fund withdrawals give rise to greater fiscal expenditure on non-contributory or solidarity pensions, which, together with the increase in the interest rate, which also affects the servicing of public debt, reduces the number of resources available to finance social programs that help the most vulnerable.

Finally, constant fund withdrawals break the virtuous circle that the individually funded system has generated in the economy. Different studies show that the accumulation of pension funds in the individually funded systems of our countries contributed to higher annual GDP growth of between 6% and 22%, due to the impact on the capital market, the labor market, savings and productivity. In turn, more robust growth favored a greater

increase in employment and real wages, and consequently higher contributions to individual accounts.

In conclusion, withdrawals without any kind of means-testing (and even limited means-testing), by depleting savings, not only exacerbate the problem of workers' pensions, but also destabilize the economies of the countries that implement them, increasing inflation and impairing the situation of the neediest.

FIAP is firmly convinced that pension reform discussion in any country should address viable and sustainable options. It makes no sense to maintain or return to PAYGO systems when faced with great demographic challenges, nor to promote the depletion of savings when the great challenge is precisely to promote savings. This process must be conducted by strong institutions and committed governments, preventing fiscal pressures and short-term political advantages from incentivizing the execution of populist reforms that deplete savings, deteriorate the social security system and affect the future well-being of the population.

We urgently call on all political parties, authorities and public policy makers of all countries, not to continue with these constant withdrawals of pension savings that are causing so much harm to workers and their families; to stop the destruction of retirement savings and to prioritize adequate reforms by adopting public policies focusing on the improvement of sustainable, long-term pensions that enable compliance with the essential purpose of a pension system, namely to reduce poverty in old age and provide sufficient pensions that replace a reasonable percentage of the income received while actively employed, with pension options that provide a stable flow of income in retirement.

Subscribed by:

- **Mr. Guillermo Arthur, FIAP President.**
- **Ms. Giovanna Prialé, Chairwoman of the Peruvian Association of Private Pension Fund Managers.**
- **Mr. Ángel Martinez-Aldama, Chairman of the Association of Collective Investment Agencies and Pension Funds, INVERCO, Spain.**
- **Ms. Paulina Yazigi, Chairwoman of the Chilean Association of AFPs.**