SOCIAL POLICIES IN RESPONSE TO CORONAVIRUS

Access to mandatory retirement savings in times of COVID-19: public policy considerations

IDB
Inter-American
Development Bank

Access to mandatory retirement savings in times of COVID-19: public policy considerations

Authors: Mariano Bosch, Carolina Cabrita Felix, Manuel García-Huitrón and María Teresa Silva-Porto[1]

1 INTRODUCTION

The global pandemic caused by COVID-19 is having a significant impact on the economies of countries around the world, and the Latin America and Caribbean (LAC) region has been no exception. Due to social distancing—one of the main tools for reducing the spread of the virus among people—different sectors of the economy have been affected, including tourism, traditional commerce, construction and real estate, among others. According to a recent estimate by the Inter-American Development Bank (IDB), up to 17 million formal jobs could be lost in this region alone (Altamirano et al., 2020). In this context, and given the need to protect workers' incomes, several countries in the region are considering the possibility of providing partial early access to pension funds.

In Peru, this access has already materialized. In early April 2020, the Peruvian government enacted a law allowing the withdrawal of approximately USD 600 from pension funds for workers who have been unemployed for the last six months. In addition, the National Congress passed a law that allows all private pension system members to withdraw 25% of their pension funds, up to a maximum of USD 4,000. In Chile, the Dominican Republic, and El Salvador, there have been proposals to allow withdrawals of 10%, 30%, and 50%, respectively, of the balance in individual accounts. In any case, this policy response is not unique to Latin America. In Australia, the government approved a lump-sum withdrawal of up to AUD 10,000 (USD 6,492) in 2020 and an equal amount in 2021. Similarly, in the United States, the CARES Act relaxed the conditions for early access to 401(k) funds, allowing members to withdraw up to USD 100,000 from a fund, either in cash or for use as collateral. These types of policies are likely to end up being discussed in many other countries around the world, as is already the case in England.

This note briefly discusses the international experience with early access to pension funds, analyzing its advantages and disadvantages. There are three main messages. First, in normal situations, allowing a degree of liquidity for pension funds presents a policy dilemma between building a pension and providing individuals with liquidity in the face of income shocks. It is up to each country to ponder this dilemma. The international experience has good examples of how this degree of liquidity can be achieved. Still, it also shows that most countries outside Latin America that allow access to funds, do so in the voluntary/complementary pillars or provide a basic pension for the vast majority of older adults. Second, in the current recession, access to pension funds should be a tool of last resort, and losses associated with financial market volatility should be avoided. Third, suppose it is not possible to avoid this policy measure due to a lack of other instruments. In that case, this document highlights some design and implementation principles that, based on the international experience, could mitigate the impact on the future adequacy of pension systems. Finally, as this note emphasizes, it is very important to ensure that payment mechanisms are safe for citizens in the current pandemic context.

2 THEORY AND EVIDENCE ON EARLY ACCESS TO MANDATORY SAVINGS

Economic theory underscores the convenience of households maintaining a level of liquid savings to smooth consumption in the face of unforeseen income shocks during their working lives.[2] This argument is consistent with the life cycle hypothesis developed by Franco Modigliani, which suggests that the needs for liquid and nonliquid savings are variable throughout individuals' working lives and that managing them optimally responds to a desire to smooth consumption (Browning and Lusardi, 1996).[3] Meanwhile, the permanent income hypothesis formulated by Nobel Prize winner Milton Friedman states that individuals respond to unforeseen and temporary changes in their current income levels by reducing their savings, if they have any, or by increasing their level of debt, anchored in their estimated future income (Friedman, 1957).[4]

Other, more recent developments in the life cycle hypothesis and its application to the design of pension systems are consistent with the idea of maintaining a percentage of liquid savings. Gourinchas and Parker (2002) showed that the life cycle hypothesis is consistent with the accumulation of reserve or preventive liquid savings ("buffer stock savings") at the beginning of the working life and up to a certain age (between 35 and 40 years, according to Cui (2008) and from that age on, saving in nonliquid form, mainly for retirement. Subsequent developments have shown that, in some cases when individuals face a severe income shock, restricted access to their pension funds can have a positive impact on their well-being (Sandris and Munk, 2020; Beshears and others, 2008, 2015 and 2019; Valdés, 2002, 2004).

---

2. One of the first references is Keynes (1936). According to Keynes, the demand for liquidity is determined by three motives: (i) transactional motive, where people prefer to have liquidity to ensure current economic transactions, both for personal and business consumption; (ii) precautionary motive, where people prefer to save money to deal with unexpected difficulties that require unusual expenses or to adapt to difficulties in employment, the economy or society; and (iii) speculative motive, where people keep liquid money hoping to take advantage of market movements at the right time. See "The General Theory of Employment, Interest and Money," Chapter 13, part II.

3. Franco Modigliani patented a method of issuing 401(k) credit cards, with the aim of making it easier for workers to withdraw savings from their retirement savings accounts to cover short-term consumption needs (Liu et al. 2014). The noted economist wrote the following: "Many governments take the paternalistic view that monies set aside for pensions should not be tapped before retirement. However, individuals who set aside savings for retirement often incur debt to finance current investment or consumption. This debt is normally in the form of mortgage loans, educational loans, or credit card balances that carry commercial or premium rates of interest, often higher than any prospective return on their mandated savings ... An inefficiently regulated system (as in the existing system) permits individuals to save in one account and dissave in another – all of which could take place in the same account. The poor structure provides large rents for financial intermediaries to the detriment of the individual" (Modigliani and Muralidhar, 2008).

4. Andersen et al. (2020) showed that in the case of Denmark, mandatory retirement savings are correlated with overindebtedness throughout the working life and that this is partly explained by a liquidity problem caused by their mandatory nature.

The reality is that in Latin America and the Caribbean, few households have preventive savings funds to smooth their consumption in the face of income shocks. Information from surveys conducted by the IDB in Brazil, Chile, Mexico, and Peru[5] shows that on average, individuals who do not have retirement savings in pension systems also have fewer savings in other vehicles, whether formal or informal (see Table 1). Even for people with relatively high incomes, the savings behaviors of those not covered by the pension system produce less savings (Cavallo et al.,

2017). In other words, for the vast majority of the working-age population in the region, pension funds are the only savings available to them.[6] Typically, mandatory savings are illiquid and reserved until retirement age.[7] However, as seen in the next section, access to compulsory or voluntary savings is common in the countries of the Organization for Economic Cooperation and Development (OECD) (García-Huitrón, 2014; García-Huitrón and Ponds, 2015; Beshears et al., 2015a and 2015b; Stewart, Jain, and Sandbrook, 2019).

TABLE Nº 1. FORMAL AND INFORMAL SAVINGS BY PENSION SYSTEM COVERAGE

COUNTRY	HAS FORMAL OR INFORMAL SAVINGS	COVERED BY PENSION SYSTEM AND HAS FORMAL OR INFORMAL SAVINGS	NOT COVERED BY PENSION SYSTEM AND HAS FORMAL OR INFORMAL SAVINGS
CHILE			
Some Savings	23.1 %	23.6 %	20.3 %
Formal Savings	22.7 %	23.2 %	20.0 %
Informal Savings	0.60 %	0.58 %	0.68 %
BRAZIL			
Some Savings	21.9 %	29.9 %	16.7 %
Formal Savings	19.3 %	27.5 %	13.9 %
Informal Savings	3.98 %	4.17 %	3.86 %
MEXICO			
Some Savings	32.2 %	49.9 %	27.5 %
Formal Savings	16.4 %	39.0 %	10.4 %
Informal Savings	19.6 %	19.3 %	19.7 %
PERU			
Some Savings	53.5 %	72.6 %	45.1 %
Formal Savings	30.5 %	59.7 %	17.6 %
Informal Savings	33.3 %	30.8 %	34.3 %

Source: IDB (2016).

In theory, partial access to mandatory pension funds may increase well-being. In practice, it presents policy dilemmas and risks that cannot be ignored. The fundamental policy dilemma that arises is the tension between a long-term objective (to build up a pension) and a short-term one (to smooth an income shock). On one hand, accessing mandatory pension funds ahead of time directly undermines the goal of obtaining a pension capable of providing a decent standard of living in old age (see Box 1), which is very relevant in the context of LAC, with high labor informality and low contribution density. On the other hand, access to funds could facilitate households' capacity to

smooth income shocks, thus improving their long-term well-being. In addition, the fact that funds have some liquidity could raise the incentives to contribute (Stewart, Jain, and Sandbrook, 2019; Valdés, 2014). This could be the case because, first, these mechanisms have the potential to increase the appeal of mandatory savings for groups of low-income and self-employed workers, who face income shocks more frequently than formal salaried workers, and, second, because it could make the benefits of saving in pension funds more tangible, increase confidence in the system and improve the sense of ownership of individual accounts.
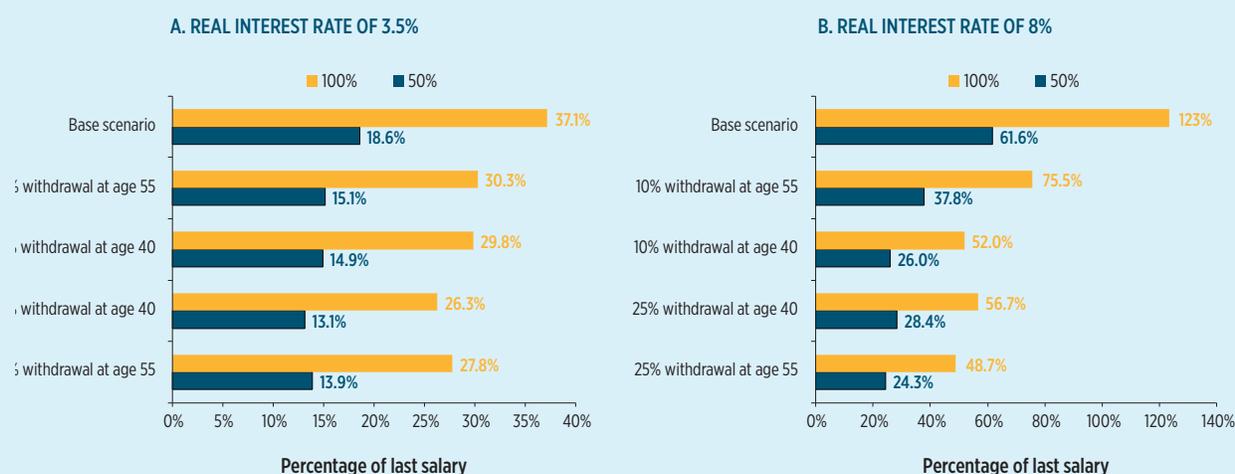
---

5. These surveys were developed within the framework of the IDB's flagship publication, "Saving for Development: How Latin America and the Caribbean Can Save More and Better." See IDB (2017). See also Tovar (2008), Valles and Aguilar (2015) and Bosch et al. (2013).

6. This is mainly the case in countries that have mandatory savings for old age through individual capitalization accounts with defined contributions.

7. With the exception of the unemployment and marriage withdrawal mechanisms in Mexico and the withdrawal reimbursement system in El Salvador, these cases are discussed in further depth below (Box 4).

BOX 1. **IMPACT OF PENSION FUND WITHDRAWALS ON PENSIONS: THE CASE OF PERU**

Based on Altamirano et al. (2018), we simulate the expected changes in replacement rates caused by allowing members of the Private Pension System (SPP) to withdraw up to 25% of the capital saved in their individual accounts. Initially, we studied two scenarios. In the first one, workers withdraw 25% upon turning 40 (20 years of effective savings), and in the second one, they do so at age 55 (35 years of effective savings). These stylized workers retire at 65 with two possible contribution density levels: 50% and 100%.

A. REAL INTEREST RATE OF 3.5%

■ 100% ■ 50%

	100%	50%
Base scenario	37.1%	18.6%
...5 withdrawal at age 55	30.3%	15.1%
...withdrawal at age 40	29.8%	14.9%
...withdrawal at age 40	26.3%	13.1%
...5 withdrawal at age 55	27.8%	13.9%

0% 5% 10% 15% 20% 25% 30% 35% 40%

Percentage of last salary

B. REAL INTEREST RATE OF 8%

■ 100% ■ 50%

	100%	50%
Base scenario	123%	61.6%
10% withdrawal at age 55	75.5%	37.8%
10% withdrawal at age 40	52.0%	26.0%
25% withdrawal at age 40	56.7%	28.4%
25% withdrawal at age 55	48.7%	24.3%

0% 20% 40% 60% 80% 100% 120% 140%

Percentage of last salary

Source: Our calculations based on Altamirano et al. (2018).

As seen in the graphics panel, early withdrawals significantly reduce replacement rates from annuities. With a return assumption of 3.5% (Graph A), withdrawals of 25% at age 40 weigh less than those made at age 55 after 35 years of contributions to individual accounts. The explanation for this is that the base from which withdrawals are made grows with age, and the number of years of future savings before retirement age decreases by the same measure. Therefore, the age at which the right to withdraw 25% is exercised plays a more important role than compound interest, at least in moderate-return scenarios.

For scenarios of higher return, for example, a real return of 8% (Graph B), compound interest plays a key role in the long term, penalizing workers who make withdrawals at an early age more than those who do not. On the other hand, compound interest in high-return scenarios would compensate for the capital losses of individual accounts over a shorter period of time, preventing the loss of savings from generating very low replacement rates. However, it is unlikely that pension systems' historical returns will remain as high in the coming decades as they have been in the past (McKinsey Global Institute, 2016; IMF, 2019 and 2020).

In short, this type of mechanism could pose a dilemma to heads of pension policy: less adequacy versus greater coverage and confidence in the system. There is no solid evidence of which way the scale tips; this area has not been investigated deeply enough. In this regard, the United Kingdom's National Employment Savings Trust (NEST) pension fund is conducting experiments based on behavioral economics in order to improve people's financial well-being in a project called "Sidecar Savings" (see Box 2 and Sandbrook, 2018). Other flagship cases at the international level, such as New Zealand's "Kiwisaver", incorporate liquidity elements in their designs (García-Huitrón and Ponds, 2015). The international evidence is explored in greater depth later.

BOX 2. **THE CASE OF NEST'S SIDECAR SAVINGS MODEL IN THE UNITED KINGDOM**

In 2018, the United Kingdom launched an initiative to test the Sidecar Savings Model's impact, where a liquid "emergency savings" account is linked to a traditional defined-contribution pension fund. This savings scheme was inspired by the work of Beshears et al. (2015), which challenges the perspective that long-term and short-term savings are a zero-sum game, where each type of savings competes for a fixed share of people's assets. Instead, it proposes an approach that combines liquid and illiquid savings in a way that optimizes the saver's needs and preferences. The argument is that a proper balance of liquidity will improve people's overall financial well-being, both in the short term and during retirement.

The Sidecar Savings Model complements the National Employment Savings Trust's (NEST) automatic enrollment scheme, automatically deducting a contribution to the pension fund through the payroll. In the Sidecar Savings structure, contributions above the automatic enrollment minimum are managed through a mechanism called "Jars", which is designed to create an optimal level of liquid savings while maximizing long-term savings.

How does the "Jars" tool work?

- If they wish to participate, savers log into a portal, where they select the amount to save for each "jar" and their savings goal (editable default values are provided as a starting point).
- Savers open a new instant-access savings account, called "Emergency Savings Jar", which is next to their "Pension Savings Jar".
- Their chosen contribution is deducted from their salary each pay period. Initially, contributions go to the "Emergency Savings Jar".
- Once the savings goal is reached, the salary deduction is deposited in the saver's pension in addition to the regular automatic enrollment pension contributions.
- Savers can withdraw money from their "Emergency Savings Jar" as often as they wish. Each time the balance falls below the savings target, contributions once again are sent to the "Emergency Savings Jar".

This initiative's results are not yet available since it was launched in 2019, and seeks to observe savers for two years to analyze how much people save in the emergency account and how different levels of savings can help protect people from financial crises.

In the case of the COVID-19 pandemic and its effects on the economy, additional considerations beyond this main tension must be weighed. The pandemic effects are simultaneously affecting the whole of society, and although they are temporary, their duration is uncertain[8] as of the publication of this note. In this context, some of the aforementioned advantages of early access to mandatory savings are magnified. For example, it is possible to argue that the countercyclical use of pension funds could have the secondary effect of helping to sustain workers' incomes, thus contributing to pension coverage and adequacy (Butrica and Smith, 2014; Ghilarducci et al., 2012).

However, other types of challenges have emerged. The interaction between the health crisis and the economy has produced a high exchange rate and asset value volatility. Under these conditions, providing access to pension funds could lead to accounting losses that may be difficult to overcome in the future, particularly for individuals closer to retirement age (see Box 3 for a more complete analysis). In addition, there are other important macroeconomic considerations. For example, a massive withdrawal of funds in a crisis context could affect the stability of the financial system and limit the debt placement options of governments.

---

8. In other words, unlike individual and independent risks, which in economic jargon are known as "idiosyncratic", such as becoming unemployed, having a work accident or a medical emergency, facing an unforeseen family event, etc., the current pandemic corresponds to a shock known as macroeconomic or aggregate. This type of shock is characterized by the fact that the risks are correlated and, in the case of the COVID-19 pandemic, there are also network effects (due to the dynamics of infection). Furthermore, the interaction between the health crisis and the economy, as well as the diversity of institutional responses specific to each country, imply that although the shock is temporary, there is a fundamental uncertainty regarding the duration of the crisis and the recovery of economic activity. For more on this, see Eichenbaum et al. (2020), Nuguer and Powell (2020), and Gollier and Straub (2020a, 2020b, 2020c).

BOX 3. THE EFFECT OF FINANCIAL VOLATILITY ON RETIREMENT AND PENSION SAVINGS

The interaction between the health crisis and the economy has generated a high exchange rate and asset value volatility. A common argument is that in these volatile conditions, providing access to pension funds could lead to accounting losses that may be difficult to overcome in the future, particularly for individuals closer to retirement age. This statement is correct in context, depending on the types of assets in which pension savings are invested and whether they follow a life cycle scheme or not. However, the change in the value of assets on the replacement rate also depends on the price of decumulation products, typically annuities or programmed withdrawals in Latin America. The latter is affected by volatility in fixed-income markets. In other words, a complete analysis of the effect of market volatility on the size of pensions requires consideration of the impact of interest rate movement on the value of annuities or, where appropriate, of programmed withdrawals. The latter effect can operate in the same direction or the opposite direction as the movement in the value of retirement savings. It is impossible to establish in advance which effect will be more predominant in terms of the most relevant indicator for members: the size of pension benefits.

A change in the value of stock indices has a similar impact on the value of pension funds, thus affecting the expected pension, but the movement of fixed-income securities affects the value of pension funds, impacting the expected pension, as well as a simultaneous effect on the value of traditional annuities (or programmed withdrawals).

To simplify the analysis, let us imagine a scenario such as the current one, with a decrease in the value of variable income securities. Additionally, imagine two scenarios concerning the value of the portfolio invested in fixed income. In scenario A, the interest rate decreases, and in scenario B, it increases.

• Scenario A: as the interest rate decreases, the fund's value increases (contrary to the effect on variable income securities). In contrast, the cost of annuities goes up (that is, pension benefits decrease).

• Scenario B: as the interest rate increases, the fund's value decreases (reinforcing the effect on variable income securities). In contrast, the cost of annuities goes down (that is, pension benefits increase).

The verdict at any moment in time is empirical. However, typically the effect on the cost of annuities tends to dominate that of the value of funds since the interest rate sensitivity of the portfolios of the insurance companies offering annuities is greater than the interest rate sensitivity of the portfolios of pension funds. This is because there is a mismatch in the average duration of both portfolios. This is the case even in countries with a multi-fund structure (Mantilla et al., 2020e; López and Walker, 2020e).[9] For example, interest rates increased at the beginning of the current health-economic shock (i.e., there was an inversion of the rate curve). In Chile's case, the effect of the fall in the price of life annuities dominated the collapse of the value of pension funds between January and March 2020, and the members who retired in those months benefited more from higher pensions than those who had retired in the previous months.[10]

---

9. The specialized literature refers to this phenomenon as one where the accumulation and decumulation stages are disintegrated. See Impavido et al. (2010).
10. For calculations in the case of Chile, see: https://www.elmercurio.com/Inversiones/Noticias/Columnas/2020/04/14/El-verdadero-efecto-del-alza-de-tasas-en-la- pension.aspx.

This crisis's unique characteristics make it necessary to reflect on the actors (institutions or individuals), the instruments (specialized or not), and the appropriate sequences for facing it. Since it impacts society as a whole, the actor best positioned to distribute the effects of the economic-health shock is the State, through its fiscal and monetary policies (Beetsma and Romp, 2016; Bonenkamp et al., 2014; Gordon and Varían, 1988).[11] For example, in the area of pension spending policy, some countries have announced the expansion of non-contributory benefits, the temporary cancellation of social security contributions, and measures for specific groups, such as the self-employed and informal workers. Also, some countries possess in-

struments designed to cover relevant risks in the current context, such as unemployment insurance in Chile, which has an individual savings component and a solidarity component. Given the current uncertainty (Eichenbaum et al., 2020; Nuguer and Powell, 2020; and Gollier and Straub, 2020a, 2020b, 2020c), it seems reasonable that instruments designed to protect employment and sources of income should be prioritized for deployment (Arboleda et al., 2020) and that instruments designed for other objectives, such as mandatory retirement savings, are used as a last resort, in the absence of alternatives, and only in a more complex scenario than the one initially foreseen by those responsible for public policy in each country.[12]

3 INTERNATIONAL EXPERIENCE

In the international experience, three operating models of access to mandatory savings can be identified during the accumulation stage of pension funds. First is Permanent Withdrawal, which allows members to access funds in the case of extreme need without having to return them (as in the cases of Australia, Denmark, the United States, Mexico, and New Zealand). Second is Loan and Repayment, which gives members the possibility of borrowing from their fund with the obligation to replace it (such as 401(k) plans in the United States and mortgage loans in Australia and Switzerland). And third is the Feeder Fund Model, which permits

the creation of a more flexible solution that combines liquid savings products and pension savings (illiquid) in a single individual account made up of several subaccounts (such as Lifetime ISA plans and potentially NEST's Sidecar Savings product in the UK, as well as in the case of Singapore). Box 4 offers further details on these models. In particular, Box 4 shows that the countries included in the review generally have a basic pension with broad coverage, and in some cases, access is permitted in the supplementary or voluntary pillars, such as in the United States, New Zealand and the European plans studied (see Box 1).

---

11. The State is the institution that can distribute the aggregate risk among the various generations more efficiently, since it can include in the fiscal contract current generations and those that have not yet been born (Gordon and Varían, 1988; Beetsma and Romp, 2016; Bonenkamp et al., 2014).

12. In the economic literature, the existence of unemployment insurance is a substitute for relying on individual 401(k) savings accounts. This is consistent with the empirical evidence that the main reason for saving in such accounts is "precautionary," as mentioned above. See Love (2006).

BOX 4. **INTERNATIONAL MODELS OF ACCESS TO MANDATORY SAVINGS IN THE ACCUMULATION STAGE**

PERMANENT WITHDRAWAL MODEL

- In **Australia**, retirement savings must be "preserved"; that is, they must not be used by workers until they reach a "retention age," currently set at 55 years, but early withdrawals are allowed for so-called "compassionate reasons", which include (i) paying for medical treatment for individuals or their dependents, (ii) managing terminal medical conditions, (iii) making a loan payment to prevent individuals from losing their primary homes, (iv) modifying a home or vehicle for the special needs of individuals or their dependents due to serious disabilities, and (v) paying for expenses associated with a death, funeral, or burial. The amount that individuals can withdraw for compassionate reasons is discretionary and limited to "reasonably necessary". A withdrawal on compassionate grounds is always paid in a lump sum. This type of withdrawal is not normally taxed, since Australia has a system that collects taxes on contributions and exempts retirement returns and benefits from income taxes (known as TEE). In 2016, the Australian government introduced a retroactive cap of AUD 1.6 million (USD 1.3 million) on withdrawals from individual accounts, charging a 15% tax on amounts exceeding that limit (Pensions Policy Institute, 2016).

- In **Denmark**, participants in occupational systems have negotiated access to part of their contributions during the accumulation stage without the need for repayment. The specific design depends on the plan, although they all face a tax system that exempts contributions and benefits from paying income taxes and imposes particularly heavy taxes on the payment of benefits in retirement (known as EET): withdrawals incur a 60% tax rate, plus administrative costs, if they are made before age 60. This may explain why, historically, only about 2% of individuals withdraw funds each year, on average.

- The New Zealand **"Kiwisaver" system** allows withdrawals before retirement age under three circumstances: (i) for the purchase of a first home, provided there is at least a three-year contribution history and that NZD 1,000 (USD 70) remains in the individual account; (ii) in the case of emigrating abroad (except to Australia); and (iii) in the case of financial difficulties. New Zealand has an ETT system (which exempts contributions from income taxes and imposes taxes on returns and benefits); therefore, early withdrawals in the Kiwisaver system are subject to income tax. In 2015, only 1.8% of 2.5 million participants in the system used the option for early withdrawals from individual accounts (Pensions Policy Institute, 2016).

- **Mexico** has "withdrawals due to unemployment" in two modes: (i) if the AFORE has been operating for at least three years and the individual can accredit at least twelve bi-monthly contributions to the Mexican Social Security Institute (IMSS), it is possible to withdraw the equivalent of 30 days of the last salary that generated contributions, with a limit of ten times the general minimum monthly wage of the Federal District; or (ii) if the AFORE has been operating for five years or more, it is possible to withdraw the lesser of the following two sums: 90 days of the salary that generated contributions over the last 250 weeks (or however many it has) or 11.5% of the individual account balance. For both modes, the eligibility requirements are as follows: (i) no contributions for 46 days (two calendar months) since the individual was dismissed from a covered job and (ii) no unemployment withdrawal during the last five years. The Mexican pension system has an EET system (as defined above), where unemployment withdrawals are not subject to income tax but are reflected in fewer weeks of contributions (which is relevant in being eligible to receive the minimum guaranteed pension).

- In **Mexico** there is the possibility of making a one-time "withdrawal for assistance with marriage expenses" for an amount equivalent to a minimum monthly salary, as long as the individual has 150 weeks of contributions and is contributing or has stopped contributing less than 90 business days before the event. These types of withdrawals are not deducted from the contribution weeks, nor are they repaid, since their funding comes from the social contribution subaccount for salaries below 15 times the minimum wage and/or from the retirement subaccount for those who contribute for an income greater than 15 times the minimum wage

LOAN AND REIMBURSEMENT MODEL

- 401(k) plans in the **United States** are examples of a loan and repayment model. There are three types of liquidity mechanisms in 401(k) plans: (i) withdrawals in situations of financial distress, usually with very limited options and amounts, such as eviction prevention or home recovery, severe financial difficulties and medical expenses; (ii) withdrawals in situations that do not require proof of financial hardship, such as the purchase of a primary home, higher education costs, among others; and (iii) clauses for full access to savings upon the termination of employment with the current employer. In any case, the existence of these benefits is a prerogative of the sponsor of the plan, and typically, they do not exceed 10% of the value of the savings and are generally subject to income tax and a penalty of 10% in the case of delinquency (Lu et al., 2014). According to VanDerhei et al. (2018), 0.40 of every dollar flows out of the 401(k) system. Regarding the delinquency rate, Lu et al. (2014) reported that only one in ten loans is not repaid and that this occurs mainly when the individual changes jobs, a circumstance in which savings can be transferred to other types of accounts under different regulatory regimes (such as IRA plans).

- **El Salvador** introduced a loan and repayment system in its 2017 pension reform. In this case, individuals must have at least ten years of contributions to their savings account in the Pension Savings System (SAP). The law allows beneficiaries early access to a percentage of up to 25% of their retirement savings, but they may also withdraw less than that percentage (5, 10, 15, or 20%) if they wish. There are two ways to repay these loans: one is with time; that is, by working five years beyond the retirement age. The AFPs have made this calculation based on the fact that in five years, it is possible to generate the total return that would have been accumulated if the person had not made the early withdrawal. The other way is to repay it in cash.

- **Switzerland** also manages a loan and repayment model, but it is limited to home loans. Individuals can have early access to retirement pension savings solely to finance an owner-occupied property up to three years before retirement. Until age 50, individuals can withdraw all their benefits acquired in the occupational plan. After age 50, the maximum amount that can be withdrawn is equal to the amount available at age 50 or half the amount currently available, whichever is greater. An early withdrawal can be repaid voluntarily, but a withdrawal is possible only every five years. The full amount of the early withdrawal must be repaid if the property is sold. Early withdrawals are taxable, but taxes paid are returned, without interest, if the sum is repaid.

FEEDER FUND MODEL

- **Singapore** operates the closest example to a feeder fund model, whereby individuals contribute to a savings product with liquidity options for a single account, managed by the Central Provident Fund (CPF). The CPF can be viewed as a lifetime savings platform for various reasons beyond retirement savings, including precautionary, educational, housing and health reasons. The amount with which plan members retire is a residual that is established at age 55, after having enjoyed the possibility of using the savings for the other permitted reasons. Singapore's system operates an EEE-type tax system (which exempts both contributions, returns, and the payment of benefits from income taxes); therefore, the use of resources for the various modes is not subject to income tax.

- The creation of the "Lifetime ISAS" account in April 2016 in the **United Kingdom** also follows this design (Pensions Policy Institute, 2016a). Individuals with this type of account receive a 25% matching contribution from the government ("government bonus") between 18 and 50. The account's balance is accessible without penalties beginning at age 60 since the account operates under a TEE system (as defined above). Suppose individuals want to withdraw the balance before that age. In that case, they may do so for the purchase of a first home, in which case they lose the government contribution and face an exit penalty of 5% of the balance in the individual account.

4 FINAL THOUGHTS

How can one balance the need for household liquidity in the short term while also satisfying the pension fund goal of providing a decent income in old age? As described in this note, there is no clear answer to this public policy dilemma. However, it is possible to observe some design principles derived from the literature review and the international practices discussed in the previous sections.

In normal situations, allowing a degree of pension fund liquidity is debatable, and it is up to each country to weigh the policy dilemmas. On one hand, the literature indicates that a limited degree of liquidity may be desirable in some contexts. On the other, this directly undermines the objective of pension adequacy. In practice, it is common to find access mechanisms in OECD countries, but not in LAC.

In the current situation, access to pension funds should be a tool of last resort. It would be desirable to build an inventory of available instruments (unemployment insurance, conditional transfers, among others) and establish an appropriate priority order. Access to pension funds should be allowed only when more efficient instruments designed specifically for the situation, such as unemployment insurance and other fiscal and monetary tools, have been exhausted. In this sense, two additional considerations should be made. On one hand, given the informality levels in the region, access to pension funds does not provide an income to those who do not save in the pension system, so it is necessary to use other instruments for this segment. On the other hand, the Peruvian experience of Law 95.5 indicates that in all likelihood, a large majority of citizens will withdraw the funds to convert them into liquid assets, even if they do not have to be facing a pressing need for consumption in the present (Altamirano et al., 2019).

The crisis caused by the spread of COVID-19 could push countries to provide access to pension funds. If due to a lack of other instruments, it is impossible to avoid this course of action, the following principles should be highlighted as useful for policy formulation:

• Mitigate the impact on the future adequacy of pension systems. This can be achieved by imposing limits on the reasons, frequency and/or amounts that can be with-

drawn. The international experience indicates that this percentage should not be more than 10% of the balance in individual accounts or rights acquired (as in 401(k) plans in the United States or the pension system in El Salvador). This limits the negative impact of financial volatility to a relatively small percentage of funds.

• An important safeguard for protecting the adequacy objective could be to use the loan and repayment system. The conditions for repayment can be established with an interest rate associated with the returns that those resources would have generated in the individual account plus a penalty that reflects the expected delinquency rate to protect the level of pension adequacy. In the event of nonpayment prior to retirement, it is possible to establish appropriate exit conditions through a combination of higher future contributions and/or the extension of working life, as appropriate for each individual.[13]

• There are additional modes for protecting pension adequacy. Two examples follow:[14]

  • Using the funds as **collateral** rather than as a direct liquidity mechanism (for reference, the recent "CARES Act" in the United States)[15] to minimize the crystallization of losses due to market volatility. This mode could also complement the monetary and credit policy measures that each country has implemented in response to the pandemic.

  • Tying the withdrawal of funds to the delivery of a **recognition bond** that the government agrees to make liquid in the future, at the retirement age. This proposal prevents the cost of the current crisis from falling on individuals by ultimately returning it to institutions, in this case to the State. Since these are subsidies conditional on having savings in the pension system, it is important to prevent them from being regressive, given that many low-income individuals in the region have no savings in the formal pension system.

• It is desirable to pay attention to governance and shield the liquidity mechanism from political pressures. Whichever mode is used (this note suggests a loan and repayment system), it is desirable to consider its governance

---

13. In the case of defined-benefit and PAYG plans, there have been proposals to make a portion of the acquired rights liquid (see Biggs and Rauh, 2020; and Sylvain et al., 2020). The proposal by Biggs and Rauh (2020) is a loan and repayment system that aims to make the system neutral to the public budget. This is achieved by tying the liquidation of rights to an increase in the future retirement age.

14. Proposals have also been made to anchor this type of mandatory savings withdrawals to a reverse mortgage-type product. See, for example: https://reverse-mortgagedaily.com/2020/04/06/the-rmd-podcast-11-dr-wade-pfau/

15. See, for example: https://www.cnbc.com/2020/03/30/op-ed-heres-how-to-take-money-from-retirement-account-under-stimulus-bill.html

to ensure that the system is protected against political pressures, avoids cross-subsidies between system participants, and ensures an intertemporal consistency that promotes actuarial neutrality between generations.

• If a country ultimately chooses to resort to this tool to reduce the impacts of the economic crisis, it is important to quickly establish digital mechanisms for processing and disbursing the amounts allowed, in a manner that complies with the health and safety protocols established by each country in response to the COVID-19 pandemic.

• Finally, although it is not the focus of this note, it is important to remember that there are other ways in which pension funds can contribute to the resolution of the current crisis; for example, through direct investment in small- and medium-sized companies (SMEs), social infrastructure and special COVID bonds, which have all been observed in other regions of the world.[16]

REFERENCES

Altamirano, A., O. Azuara y S. González. (2020), ¿Cómo impactará la COVID-19 al empleo?: Posibles escenarios para América Latina y el Caribe Nota Técnica. Abril 2020, *Banco Interamericano de Desarrollo*.

Altamirano, A., M. Bosch, S. Berstein, M. García-Huitrón, M.L. Oliveri. (2018). Presente y Futuro de las Pensiones en América Latina y el Caribe. Monografía, *Banco Interamericano de Desarrollo*.

Altamirano, A., M. Bosch, S. Berstein, G. Caballero, L. Keller, M. García-Huitrón, M.T. Silva-Porto. (2018). El Sistema de Pensiones Peruano: Diagnóstico y Avenidas de Reforma." Nota Técnica. Diciembre 2019, *Banco Interamericano de Desarrollo*.

Andersen, H. Y., N. L. Hansen, and A. Kuchler. (2020). "Mandatory Pension Savings and Long-run Debt Accumulation: Evidence from Danish Register Data." SSRN. Available at: http://dx.doi.org/10.2139/ssrn.3547997

Arboleda, O.; D. Baptista, C. González-Velosa, R. Novella, D. Rosas-Shady, M.T. Silva Porto, N. Soler, (2020), Respuestas al impacto del coronavirus (COVID-19) en los mercados laborales de América Latina y el Caribe, Políticas Sociales en Respuesta al Coronavirus, abril 2020, *Banco Interamericano de Desarrollo*.

Beetsma, R. y W. Romp. (2016). "Intergenerational Risk Sharing." Editor(s): John Piggott, Alan Woodland, *Handbook of the Economics of Population Aging*, North-Holland, Volume 1.

Beshears J, Choi J, Clayton C, Harris C, Laibson D, Madrian B. (2019). "Optimal illiquidity." *Working Paper*.

Beshears J, Choi JJ, Hurwitz J, Laibson D, Madrian BC. (2015a). "Liquidity in Retirement Savings Systems: An International Comparison." *American Economic Review Papers and Proceedings* 2015; 105(5):420-425.

Beshears, J., Choi, J. J., Hurwitz, J., Laibson, D., and Madrian, B. C. (2015b). "Liquidity in Retirement Savings Systems: An International Comparison." *American Economic Review*, 105(5):420–25.

Biggs, A., y J. Rauh. (2020). "Funding Direct Payments to Americans Through Social Security Deferral." Stanford University Graduate School of Business Research Paper No. 3580533. Available at http://dx.doi.org/10.2139/ssrn.3580533

Bonenkamp, J., y L. Meijdam y E. Ponds y E. Westerhout (2014). "Reinventing international risk sharing." Netspar. Panel Paper 40. Multi-pillar pension schemes and macroeconomic performance.

Bosch, M., Melguizo y C. Pagés. (2013). *Mejores Pensiones, Mejores Trabajos*. Washington, D.C.: *Banco Interamericano de Desarrollo*.

Browning, M. and A. Lusardi. (1996). "Household Saving: Micro Theories and Micro Facts." *Journal of Economic Literature*, Vol. 34, No. 4, pp. 1797-1855.

---

16. These avenues also have advantages and disadvantages. See Didier et al. (2020), Inderst (2020) and Bonenkamp et al. (2014) to expand on these issues.

Butrica, B. A. and Smith, K. E. (2014). "401(k) participant behavior in a volatile economy." *Journal of Pension Economics and Finance*, FirstView:1–29.

Cavallo, E., T. Serebrisky, V. Frisancho, J. Karver, A. Powell, D. Margot, A. Suárez-Alemán, E. Fernández-Arias, M. Marzani, S. Berstein, M. Bosch, M. Oliveri; A. Izquierdo, M. Busso, A. Fernandez, C. Tamayo. (2017) *Saving for Development: How Latin America and the Caribbean Can Save More and Better*. Development in the Americas Series. *Interamerican Development Bank*.

Creedy, J., N. Gemmell y G. Scobie (2014) "Pensions, Savings and Housing: A Life-cycle Framework with Policy Simulations" *Treasury Working Paper Series* 14/14. New Zealand.

Cui, J. (2008). "DC Pension Plan Defaults and Individual Welfare". NETSPAR Working Papers, 09-2008(37).

Didier, T., F. Huneeus, M. Larrain, y S. Schmukler, 2020. "Financing Firms in Hibernation during the COVID-19 Pandemic," Research and Policy Brief, No. 30, World Bank Chile Center and Malaysia Hub.

Davidoff, T. (2009). "Housing, health, and annuities." *Journal of Risk and Insurance*, 76(1).

Eichenbaum, M., S. Rebelo, and M. Trabandt. (2020). "The Macroeconomics of Epidemics." NBER Working Paper 26882, National Bureau of Economic Research, Cambridge, MA.

FMI 2019. Global Financial Stability Report: Lower for Longer. World Economic and Financial Surveys. Washington, DC: International Monetary Fund.

FMI 2020. Global Financial Stability Report: Markets in the Time of COVID-19. World Economic and Financial Surveys. Washington, DC: International Monetary Fund.

Friedman. M. (1957). *A Theory of the Consumption Function*. Princeton University Press.

García-Huitrón, M. (2014). "The Role of Annuities, Partial Lump-Sums and Special Purpose Withdrawals in Pension Design." Tesis. NETSPAR y APG.

García-Huitrón, M. y E.H.M. Ponds (2015). "Participation and Choice in Funded Pension Plans: Guidance for the Netherlands from worldwide diversity" NETSPAR Design Paper.

Ghilarducci, T., Saad-Lessler, J., and Fisher, E. (2012). "The macroeconomic stabilization effects of social security and 401(k) plans." *Cambridge Journal of Economics*, 36(1):237–251.

Gollier, C. y S. Straub. (2020a). "Some micro/macro insights on the economics of coronavirus. Part 1: Impact assessment and economic measures." Vox Europe.

Gollier, C. y S. Straub. (2020b). "Some micro/macro insights on the economics of coronavirus. Part 2: Health policy." Vox Europe

Gollier, C. y S. Straub. (2020c). "Some micro/macro insights on the economics of coronavirus. Part 3: Extreme risk management." Vox Europe

Gordon R. y H. Varian. (1988). "Intergenerational Risk Sharing." *Journal of Public Economics*, Vol.37, no. 2, pp. 185-202.

Gourinchas, P.-O. y Parker, J. A. (2002). "Consumption Over the Life Cycle". *Econometrica,* Econometric Society, 70(1):47–89.

Impavido, G., E. Lasagabaster, E., y M. Garcia-Huitron (2010). *New Policies for Mandatory Defined Contribution Pensions: Industrial Organization Models and Investment Products*. Inter-American Development Bank. Available at https://publications.iadb.org/en/new-policies-mandatory-defined-contribution-pensions-industrial-organization-models-and-investment.

Inderst, G. (2020). "Social Infrastructure Finance and Institutional Investors. A Global Perspective." Discussion Paper PI-2006. Pensions Institute, Cass Business School.

López, F. and Walker, E. (2020e) "Investment performance, regulation and incentives: the case of Chilean pension funds," *Journal of Pension Economics and Finance*. Cambridge University Press, pp. 1–26. Por publicarse en 2020.

Love, D. (2006). "Buffer stock saving in retirement accounts". *Journal of Monetary Economics*, Elsevier, 53(7):1473–1492

Love, D. A. (2007). "What can the life-cycle model tell us about 401(k) contributions and participation?" *Journal of Pension Economics and Finance*, 6:147–185

Lu, T., Mitchell, O. S., Utkus, S. P., and Young, J. A. (2014). "Borrowing from the Future. 401(k) Loans and Loan Defaults." Technical Report.

Mckinsey Global Institute. (2016). "Diminishing Returns: Why Investors Need to Lower Their Expectations" Mckinsey Co.

Mantilla, D. y J. J. Ospina. (2019). "Bonos para la jubilación: un elemento fundamental para la reforma pensional." Mimeo, Facultad de Administración, Universidad de los Andes.

Mantilla, D., M. Martinez, M. Garcia-Huitron y A. Muralidhar. (2020e). "From Defined Contribution Towards Target-Income Retirement Systems." Working Papers, Universidad de Los Andes. Disponible en: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3585154.

Merton, R. C., y A. Muralidhar, Arun. (2020). "SeLFIES: A New Pension Bond and Currency for Retirement" (March 4, 2020). Available at http://dx.doi.org/10.2139/ssrn.3548319.

Modigliani, F. (1970) "The life-cycle hypothesis and intercountry differences in the saving ratio," in W. A. Eltis, M. FG. Scott, and J. N. Wolfe, eds., Induction, growth, and trade: essays in honour of Sir Roy Harrod, Oxford. *Oxford University Press*. Pp 197–225.

Modigliani, F. y A. Muralidhar. (2006). *Rethinking Pension Reform*. Cambridge Universit Press.

Nuguer V. y A. Powell. (2020). *Políticas para combatir la pandemia*. Informe macroeconómico de América Latina y el Caribe 2020. Banco Interamericano de Desarrollo.

Pensions Policy Institute (2016). "Lifetime ISAs - the international evidence." Briefing Note 82

Sandbrook, W. (2018). Liquidity and Sidecar Savings. AARP International: The Journal, 11, 20. doi:10.26419/int.00001.006

Sandris L. y C. Munk. (2020). "The Design and Welfare Implications of Mandatory Pension Plans." Working Paper, Pension Research Center (PeRCent). Copenhagen Business School.

Stewart, F., y H. Jain, y W. Sandbrook. (2019). "Early Access to Pension Savings: International Experience and Lessons Learnt." World Bank.

Sylvain, C., M. Miller, N. Sarin. (2020). "Relaxing Household Liquidity Constraints through Social Security (May 4, 2020)." Available at http://dx.doi.org/10.2139/ssrn.3593054.

Tovar, J. (2008). "Caracterización del ahorro de los hogares en Colombia." Documento de Trabajo, Universidad de los Andes.

Valdés, S. (2002). *Pension Policies and Pensions Markets: a University Textbook for Latin America*. Catholic University Press.

Valdés, S. (2004). "Improving Mandatory Saving Programs." Office of the Chief Economist, The World Bank.

Valdés, S. (2014). Presentación ante la Comisión Asesora Presidencial sobre el Sistema de Pensiones. Comisión Bravo, Chile.

VanDerhei, J., Holden, S., Alonso, L., and Bass, S. (2018). "401(k) plan asset allocation, account balances, and loan activity in 2016." EBRI Issue Brief, (394).

Valles, Y. y A. Aguilar. (2015). "El ahorro en México: evidencia de los hogares". Estudios Económicos CNBV - Volumen 3, 2015.

iadb.org/en/coronavirus   @the_IDB   IDB