

THE USE OF THE INSURANCE METHOD IN THE PERU PENSION SYSTEM

*JAROSŁAW POTERAJ**

KEYWORDS

pensions, pension systems, insurance method, Peru

ABSTRACT

The unique formula of the pension system in Peru consists of two competing schemes - a public pay-as-you-go scheme (SNP) and a privately funded scheme (SPP). However, only the SNP scheme can be considered as a solution using the insurance method due to the presence of a premium as a source of financing and a common risk fund. On the other hand, SPP uses an investment method to accumulate retirement resources. Using the example of Peru, it can also be stated that the influence of „black swans” (such as the COVID-19 pandemic) on human behaviour may lead to the complete annihilation of resources accumulated with rational justification intended for retirement purposes.

I. INTRODUCTION

The pension system operating in Peru is a unique formula on a global scale of parallel functioning of pay-as-you-go and capital-based schemes. The formula of freedom of choice, practically unavailable in countries reforming their pension systems since 1994, was preserved in Peru, which introduced the pension reform by law at the end of 1992 and modelled it on the Chilean reform.

* Ph.D., Assistant Professor, University of Lomza, Poland; Email: jpoteraj@al.edu.pl

The insurance method, as a way of transferring risk by transferring losses to another entity, is widely recognized as one of the ways to ensure financial security during the period of inactivity due to advanced age¹. In the historical development of pension concepts, the insurance method was used from the beginning, being the basis for the pension structure proposed in 1889 by Bismarck². The author also wrote about the insurance method in managing old age risk in theoretical considerations from 2011³ and in application, on the example of Austria, in 2013⁴.

There is a lot of literature on pension issues in Peru, both in Spanish and English. Many of them are used by the author and included in the bibliography. However, in Poland, the Peruvian pension system has only been examined twice so far, and each time in partial exemplification only. Both examples come from articles by Stańko published in 2010. The first discusses multi-funding in pension systems⁵, and the second examines transfers of funds between pension funds⁶.

In this article, the descriptive method was used to present historical changes, and the desk research method was used to present the current state and to formulate hypotheses. The author hypothesises that the insurance method, permanently present in the Peruvian pension system, is decreasing its importance in favour of the investment and supply from budget funds methods and an auxiliary hypothesis that the impact of “black swans” on human behaviour may lead to the complete annihilation of resources accumulated with rational justification for retirement purposes. The article is presented in the following order: 1. General information about the country, 2. Historical development of the pension system, 3. Current state of the pension system and 4. Challenges and expected changes in the pension system.

¹ Szumlicz Tadeusz, *Ubezpieczenie społeczne. Teoria dla praktyki* (Oficyna Wydawnicza Branta 2006) 83.

² Muszalski Wojciech, *Ubezpieczenie społeczne. Podręcznik akademicki* (Wydawnictwo Naukowe PWN 2006) 38 and Poteraj Jarosław, ‘Pension Concepts in Europe - from Otto von Bismarck to the OMC’ OPTIMUM. *Studia Ekonomiczne* nr 3 (39), (Uniwersytet w Białymstoku 2008), 199-218.

³ Poteraj Jarosław, ‘Metoda ubezpieczeniowa w zarządzaniu ryzykiem starości’ (2011) in: *Ubezpieczenia gospodarcze i społeczne. Wybrane zagadnienia ekonomiczne*, Ed. by Wanda Sułkowska, (Oficyna a Wolters Kluwer business 2011) 183-195.

⁴ Poteraj Jarosław, ‘Wykorzystanie metody ubezpieczeniowej w systemie emerytalnym Austrii’ (2013), in: *Rynek ubezpieczeń. Współczesne problemy* Ed. by Wanda Sułkowska, (Difin 2013) 344-354.

⁵ Stańko Dariusz, ‘Doświadczenia we wprowadzaniu wielofunduszowości w innych krajach’ (2010a), in: *Wielofunduszowość w systemie emerytalnym*, Ed. by Aleksandra Wiktorow and Bohdan Wyżnikiewicz, (Instytut Badań nad Gospodarką Rynkową 2010) 24-44.

⁶ Stańko Dariusz, ‘Transfery członków kapitałowych funduszy emerytalnych na świecie i w Polsce. Analiza racjonalności decyzji członków OFE’ (2010b), „Rozprawy Ubezpieczeniowe” Zeszyt 8(1/2010) 7-36.

II. GENERAL INFORMATION ABOUT THE COUNTRY

The Republic of Peru⁷ (Spanish: *República del Perú*) is a country located in the western part of South America, on the Pacific Ocean, consisting of 25 departments (*departamentos*) and a constitutional province (*Municipalidad Metropolitana de Lima*). The monetary unit is the new sol⁸ (PEN⁹, *nuevo sol*). The official language is Spanish. In mid-2023, Peru had a population of 32,440,172 people¹⁰ with the following age structure of the population: 0-14 years - 26.04%, 15-64 years - 65.94%, 65 years and more - 8.02%. The average life expectancy at birth was 68.9 years in total, including 65.4 years for men and 72.7 years for women. The majority of the inhabitants were mestizos, who constituted 60.2% of the population, with fewer Indians (25.8%), and much fewer whites (5.9%) and blacks (3.6%). The religious groups were dominated by Catholics (60.0%), and there were much fewer Evangelicals (11.1%). According to the 1993 constitution, the head of state and government is the president (from December 7, 2022, Dina Ercilia BOLUARTE Zegarra). The largest political groups are: *Fuerza Popular*, *Perú Libre* and *Acción Popular*. Gross domestic product (GDP) per capita (PPP) in 2022 was estimated at USD 15,052¹¹, and the GDP growth rate at 2.7%. The unemployment rate was 3.7% and public debt accounted for (2022¹²) 34.25% of GDP. The current account balance of payments closed in 2021 with a deficit of USD 5,273 billion.

III. HISTORICAL DEVELOPMENT OF THE PENSION SYSTEM IN PERU

The beginnings of the broadly understood social security system in Peru date back to 1911¹³, when accident insurance appeared, expanded in 1935 to include occupational diseases. However, pension regulations in Peru appeared in

⁷ *Wielka Encyklopedia PWN*, (Wydawnictwo Naukowe PWN 2004), v. 20, 490-497.

⁸ The new sol has been the monetary unit of Peru since 1991. Before the currency reform in 1991, the monetary unit was the *inti*, which was introduced in 1985 instead of the sol.

⁹ Abbreviation according to the ISO 4217 standard. On February 26, 2024, 1 EUR was worth PEN 4.1216, and in Poland on February 26, 2024, 1 PEN was worth PLN 1,0560. Compare: Bloomberg <https://www.bloomberg.com/markets/currencies/cross-rates> access 2024.02.26 and NBP <http://www.nbp.pl/home.aspx?f=kursy/kursyb.html> access 2024.02.26.

¹⁰ CIA <https://www.cia.gov/the-world-factbook/countries/peru/#people-and-society> access 2024.02.26.

¹¹ TWBI <https://data.worldbank.org/indicator/NY.GDP.PCAP.PP.CD?locations=PE> access 2024.02.26.

¹² countryeconomy.com <https://countryeconomy.com/national-debt/peru> access 2024.02.26.

¹³ *Social Security Programs Throughout the World: The Americas, 2019*, (Social Security Administration 2020), Office of Retirement and Disability Policy & Office of Research,

1936¹⁴, when the first pension solution for hired workers in this country was created. In the same year, workers were covered by sickness insurance¹⁵. In 1948, sickness insurance also covered white-collar workers¹⁶. In 1962¹⁷, a general pension law was introduced for white-collar workers. It was then that a special retirement solution for government employees, the so-called „*cedula viva*”¹⁸.

In the 1970s, Peru implemented a “segmented universalism” model of social protection policy. The two main areas of action are: a) improving traditional social policy sectors such as education, health, pensions and housing and b) reforming fiscal policy to increase redistribution and reduce economic and social inequalities. In the education and health sectors, Peru has developed a public system with free services aimed at the poorest segments of the population. It also developed an important housing policy based on the “young cities” program (*pueblos jóvenes*) managed by the National Housing Fund (*Fondo Nacional para la Vivienda*, FONAVI)¹⁹. In 1973, a general pension regulation appeared²⁰. On its basis, on May 1, 1973, the National Pension System (*Sistema Nacional de Pensiones*, SNP) began operating as a public pay-as-you-go scheme, and, as the institution managing it, the National Pension Office (*Oficina de Normalización Previsional*, ONP). From January 1, 1974, a special pension scheme for uniformed services was established, managed by the Military and Police Pension Fund (*Caja de Pensiones Militar-Policial*)²¹. The 1979 constitution recognized social security and welfare, as well as integral health care and free education, as universal rights

Evaluation, and Statistics, SSA Publication No. 13-11804, Released: March 2020, Washington, DC, 233.

¹⁴ *Social Security* (n 13) 228.

¹⁵ *Social Security* (n 13) 232.

¹⁶ *Social Security* (n 13) 232.

¹⁷ *Social Security* (n 13) 228.

¹⁸ This program was originally intended to cover only public employees who started their administrative careers before 1962. It was supposed to end with the 1973 reform, but instead of disappearing, it became a special public pension scheme for the following groups of employees: teachers who started working before 1980, employees of state-owned companies and judges. Nowadays, it covers retirement (with a contribution of 13% of remuneration for at least 15 years for men and 12.5 years for women), disability, widowhood, orphanage, and also offers a pension even for parents dependent on deceased employees. Compare: Lavigne Milena, *Social protection systems in Latin America and the Caribbean: Peru*, (Economic Commission for Latin America and the Caribbean (ECLAC) 2013) 13.

¹⁹ Lavigne (n 18) 7.

²⁰ Decreto Ley N° 19990 (1973), 30 de abril de 1973 *Se crea el Sistema Nacional de Pensiones de la Seguridad Social*, accessed at: https://cdn.www.gob.pe/uploads/document/file/251495/226861_file20181218-16260-fwxyt.pdf access 2024.02.26.

²¹ Estado Peruano <https://www.gob.pe/520-elegir-sistema-de-pensiones-caja-de-pensiones-militar-policial> access 2024.02.26.

that must be guaranteed by the state²². In 1979, Peru introduced the extension of sickness insurance to the area of maternity²³. In 1989²⁴, legal regulations on family benefits appeared, and in 1991²⁵ on benefits for unemployed persons. In the early 1990s, the SNP technically went bankrupt as a result of demographic changes and political and economic factors²⁶. The managed assets were used in accordance with current political interests, and a special benefit scheme was created, the so-called *cédula viva* (“decree of life”), to favour “government-connected” employees²⁷. If we combine these factors with the serious economic crisis that hit the country in the 1980s, the need for a drastic pension reform became obvious. In 1992, the number of contribution years required to obtain a full pension was increased from 13 years for women and 15 years for men to 20 years for both sexes, and the formula for calculating the maximum pension was changed from 80% of 10 times the minimum wage (then PEN 4,000 per month) for a fixed, administratively determined amount (at that time it was PEN 857 per month)²⁸. By law at the end of 1992²⁹, a system of individual pension accounts was introduced from June 1993³⁰.

Established in 1993, the Peruvian pension system, largely modelled on the Chilean system, gave workers the choice of contributing to a pay-as-you-go system, financed by public funds, or to an individual account managed by one of eight pension fund management companies (*Administradoras de Fondos de Pensiones*, **AFP**)³¹. Each AFP could establish one pension fund with a balanced

²² Lavigne (n 18) 7.

²³ *Social Security* (n 13) 232.

²⁴ *Social Security* (n 13) 235.

²⁵ *Social Security* (n 13) 234.

²⁶ Ramos Jorge, ‘Dual system in Peru still finding its feet’, *Global Pensions* February 2005.

²⁷ Under these provisions, certain government retirees, including former legislators, were entitled to a fully indexed lifetime pension equal to the current salary of a current official in the position held by the retiree. After the retiree’s death, the spouse and unmarried daughters continued to receive the same benefit.

²⁸ Bernal Noelia, Muñoz Angel, Perea Hugo, Tejada Johanna, Tuesta David, ‘A look at the Peruvian Pension System: Diagnosis and Proposals’, (BBVA 2008) *Pension Studies Series*, 33.

²⁹ *Decreto Ley 25897* (1992) del 6 de diciembre de 1992.

³⁰ Queisser Monika, ‘Pension Reform and Private Pension Funds in Peru and Colombia’, The World Bank, Policy Research, Working Paper 1853, Financial Sector Development Department, November 1997, 1.

³¹ At the end of 1993, these AFPs were: Integra, Profuturo, Horizonte, Unión, Nueva Vida, El Roble, Providencia and Megafondo. Already in 1994, AFP Megafondo (merged with Horizonte in August 1994) and AFP Providencia (merged with Nueva Vida in November 1994) were liquidated. In 1996, AFP El Roble was liquidated (merged with Profuturo in September 1996). In 2000, after the merger of AFP Unión and AFP Nueva Vida, AFP Unión Vida was created. In 2005, AFP Prima was established. In 2006, AFP Unión Vida was liquidated. In 2013, AFP Horizonte was liquidated, and AFP Habitat appeared on the market.

investment portfolio. The funds were to be supervised by a government oversight agency (*Superintendencia de AFPs*, **SAFP**). Employees entering the labour market had a choice between the new privately funded scheme (*Sistema Privado de Pensiones*, **SPP**), operating as individual accounts, and the old public scheme (*Sistema Nacional de Pensiones*, **SNP**), operating in the pay-as-you-go formula. They had 10 days from the start of work to make a decision, and if they did not make it, they were sent to SPP.

Employees covered by the SNP public scheme could switch to individual accounts at any time but could not return to the public scheme. The participation of self-employed people was voluntary. The statutory retirement age for the SNP was 60 for men and 55 for women, with at least 20 years of contributions. Despite drastic solvency problems, SNP contributions remained at 9% of earnings.

The statutory retirement age for SPP is 65, with the possibility of early retirement at any age if assets accumulated in the individual account replace at least 50% of average earnings over the last 120 months. The SPP contribution was set at 11% of remuneration³². Contributions made by the employee were recorded in a personal account called the Individual Capitalization Account (*Cuenta Individual de Capitalización*, **CIC**). Unlike the Chilean pension reform, the Peruvian reform assumes the continuation of the coexistence of two pension schemes - the old (pay-as-you-go) and the new (funded) scheme. As in Chile, workers moving to the private scheme were eligible to receive bonds for their previous contributions to the public pillar. Unlike Chilean solutions³³:

- no minimum pension guarantee has been introduced in Peru,
- mandatory and voluntary contributions to individual accounts were not tax deductible, but pension benefits were taxed,
- no earnings limits were introduced for paying mandatory pension contributions, but pension and family insurance contributions were subject to earnings limits,
- discretionary bonds do not actually bear interest³⁴, i.e. they are indexed to prices and receive a zero real interest rate,
- a maximum limit (PEN 60,000³⁵) was introduced to recognize past contributions to the old system,
- new employees in the workforce are not automatically affiliated with the new system - they have the right to choose, and
- there is a uniform retirement age of 65 for men and women.

³² Queisser (n 30) 1.

³³ Queisser (n 30) 3.

³⁴ In Chile they had an interest rate of 4%.

³⁵ TWB, 'Peru's Private Pension System: An Analysis of its Evolution, Current Market Structure and Recommendations for Reform', The World Bank, Finance, Private Sector and Infrastructure Department, Latin America and the Caribbean Region, July 2003, 15.

In 1995, the SNP contribution was increased from 9% to 11% of earnings, and the SNP retirement age was increased to 65 for both sexes³⁶. Moreover, the legal possibility of introducing a guaranteed minimum pension in SPP was introduced (without practical application)³⁷.

In 1996, participants in the *cédula viva* (“decree of life”)³⁸, a special legal arrangement for government pensioners, were allowed to transfer to the SPP and provided incentives for such transfers, while also creating a reserve fund (*Fondo Consolidado de Reservas Previsionales*, **FCR**) financed by privatization proceeds, to cover the liabilities of the public scheme. Until June 1996, return from the private to public system was allowed for women and men over the age of 50 and 55 respectively. At the end of 1996, approximately 1.55 million workers were affiliated with the SPP, representing approximately 18% of the estimated economically active population, and another million workers (approximately 12% of the economically active population) were affiliated with the SNP public scheme³⁹.

From January 1, 1997, the amount of the SNP pension contribution was increased to 13% of remuneration⁴⁰.

In 2000⁴¹, the possibility of early retirement was introduced. According to estimates by the International Labor Organization, approximately 50% of the economically active urban Peruvian population operated in the informal economy in 2000⁴².

In 2001, SAFP entered the structure of the Banking and Insurance Supervision (*Superintendencia de Banca y Seguros*, **SBS**) in the form of supervision of private pension funds⁴³. Moreover, in 2001, a minimum old-age pension was introduced (*Pensión Mínima de Vejez*)⁴⁴. All Peruvian workers who have paid contributions for at least 20 years (in a public or private pension system) became eligible for this benefit. It is specifically intended for older people whose pension amount is lower than the established minimum.

³⁶ Bernal (n 28) 33.

³⁷ Queisser (n 30) 20.

³⁸ SSA International Update https://www.ssa.gov/policy/docs/progdesc/intl_update/2004-07/index.html access 2024.02.26.

³⁹ Queisser (n 30) 3.

⁴⁰ Bernal (n 28) 33.

⁴¹ *Social Security* (n 13) 228.

⁴² A Li Carmen, Olivera Javier, ‘Participation in the Peruvian reformed pension system’ (2005) access at: <https://core.ac.uk/download/pdf/9066547.pdf> 3.

⁴³ TWB (n 35) 2.

⁴⁴ Lavigne (n 18) 15.

From 1996 to 2002, funds managed by AFPs grew at an average annual rate of 29.7%. However, among SPP participants in June 2002, only 39.1% paid pension contributions⁴⁵. The average ROE achieved in 2002 for AFPs alone was 59.6%, and the average in the period 1996-2002 was 38.8%⁴⁶. In December 2002, the SPP contribution was 8% of remuneration. Additionally, the participant paid a commission to AFP (its average value was approximately 2.27% of remuneration) and 1.24% to disability insurance. The total contribution burden of an SPP participant was approximately 11.51% of remuneration, and 26.9% of the economically active population participated in SPP⁴⁷. In 2002, the legal possibility of operating a guaranteed minimum pension in SPP, which had existed since 1995, was introduced⁴⁸. In 2002, a formula was also adopted to systematically reduce the replacement rate in the SNP from the then applicable 50% to 30% from 2038 and to calculate the reference value as the average of the last 60 months⁴⁹.

A law from December 2003 obliged AFPs to offer three different types of funds with different levels of risk, instead of the previous solution of one fund⁵⁰ with a balanced investment portfolio⁵¹. The second fund would invest mainly in fixed-interest instruments, and the third in shares.

In April 2004, changes were made to the special legal regulation *cédula viva* (“decree of life”)⁵². According to them, certain government retirees, including former legislators, were entitled to a fully indexed lifetime pension equal to the current salary of a current official in the position held by the retiree. After the retiree’s death, the spouse and unmarried daughters continued to receive the same benefit. However, the changes did not apply to acquired rights and were limited to future retirees, introducing a ceiling for their retirement benefits. The regulation of May 2004 allowed employees until the end of July 2005 to submit an application to switch from the individual account system back to the public pay-as-you-go system. However, such a transition had to be approved by a multi-sector

⁴⁵ TWB (n 35) 15.

⁴⁶ TWB (n 35) 2.

⁴⁷ TWB (n 35) 8 & 9.

⁴⁸ Moròn Eduardo, ‘The Peruvian Pension Reform’, (2007) Documento de Discusión DD 07/04, Centro de Investigación de la Universidad del Pacifico, 4.

⁴⁹ Bernal (n 28) 33.

⁵⁰ The average exposure of this type of funds in particular types of financial instruments was then: 21% in government bonds, 7.5% in shares, 11% in private sector bonds, 28% in the financial sector and 8.5% in foreign securities.

⁵¹ SSA International Update https://www.ssa.gov/policy/docs/progdesc/intl_update/2003-12/index.html access 2024.02.26.

⁵² SSA International Update https://www.ssa.gov/policy/docs/progdesc/intl_update/2004-07/index.html access 2024.02.26.

committee, which included representatives of SBS, ONP, pension companies, the Ministry of Economy and Finance (*Ministerio de Economía y Finanzas*), the People's Ombudsman, pensioners and pension account holders. In May 2004, approximately 3.2 million employees had individual accounts and approximately 0.15 million employees were covered by the public pay-as-you-go system. On November 11, 2004, the Peruvian Congress approved an amendment to the Constitution allowing *cédula viva* benefits to be limited to PEN 6,400 per month⁵³.

At the beginning of 2005, pension contributions to the SNP were increased to 13% of salary. Until May 2, 2005, all AFPs operating in Peru were required to register at least two pension funds⁵⁴: Type 1, **an equity hedge fund** with up to 10% equities and up to 100% fixed income, and Type 2, **a mixed fund** with up to 45% equities and up to 75% fixed income. AFPs could also offer an optional third pension fund: Type 3, which is **a growth fund** with a maximum of 80% of assets in equities and a maximum of 70% of assets in fixed income instruments. The funds collected so far were automatically transferred - in the case of people aged up to 60 years to the Type 2 fund, and in the case of people over 60 years of age to the Type 1 fund. This obligation was a result of the legal regulation from 2003. In 2005, of the 12.8 million economically active people aged 20-64, only 4.7 million people were covered by all existing pension arrangements in Peru. Of the remaining over 8 million people, 49% had an income of less than PEN 500 per month, and another 43% earned between PEN 500 and 800 per month⁵⁵. In August 2005, a new AFP called "Prima" was registered, owned by Credicorp, the largest financial holding company in Peru⁵⁶, which offered the lowest administration fee⁵⁷. The multi-fund scheme started collecting resources from December 12, 2005.

At the beginning of 2006, the amount of the SPP contribution was restored to the statutory level of 10% from 8% in force in 1996-2005⁵⁸. In July 2006, the Pension Supervision Authority (SBS) published a preliminary report on the status

⁵³ SSA International Update https://www.ssa.gov/policy/docs/progdesc/intl_update/2004-12/index.html access 2024.02.26.

⁵⁴ SSA International Update https://www.ssa.gov/policy/docs/progdesc/intl_update/2005-03/index.html access 2024.02.26.

⁵⁵ Bernal (n 28) 106.

⁵⁶ SSA International Update https://www.ssa.gov/policy/docs/progdesc/intl_update/2005-09/index.html access 2024.02.26.

⁵⁷ This was 1.5% of an employee's earnings, compared with 2.27% for the average fee charged by other AFPs in July 2005.

⁵⁸ SSA International Update https://www.ssa.gov/policy/docs/progdesc/intl_update/2006-01/index.html access 2024.02.26.

and desired directions of changes in the Peruvian pension system⁵⁹. On November 9, 2006, the central bank increased the limit on the share of investments in foreign securities for pension funds from 10.2% to 12.0%, with the option of further changes in the future⁶⁰. At the end of 2006, the current SNP deficit was estimated at the equivalent of over USD 21 billion, of which USD 10.6 billion were existing liabilities to retirees (460,539 pensioners received benefits at that time), and USD 9.9 billion were liabilities to professionally active people, without coverage from the SNP's assets⁶¹.

The law of March 2007 allowed employees who were contributors to the public system before December 31, 1995, and later became participants in the individual pension account scheme, to return to the public system⁶². In 2007, more than 40% of people aged 75 or older were considered poor; in rural areas, approximately 65% of this age group was poor⁶³. At the same time, less than 10% of people aged 60 and over received any pension. In 2007⁶⁴, the possibility of early retirement for unemployed people was introduced. Estimates of the structure of Peru's labour force in 2007 included 20% formal workers, 50% independent and informal workers, 22% dependent but informal workers, and 8% unemployed. Of these groups, only the first one was present in pension solutions⁶⁵. At the end of 2007, the lowest and highest SNP pensions were PEN 415 and PEN 857 per month, respectively, and were paid 14 times a year⁶⁶. In 2007, FCR was co-financed with an amount equivalent to USD 2.1 billion⁶⁷.

On November 3, 2008, the Pension Supervision Authority (SBS) presented to Congress a proposal to introduce changes to the system of mandatory individual accounts, including the introduction of the obligation for AFP to operate a fourth (low-risk) fund with a guaranteed minimum rate of return, and the introduction of government subsidies for account holders over the age of 65 years who have

⁵⁹ SSA International Update https://www.ssa.gov/policy/docs/progdesc/intl_update/2006-08/index.html access 2024.02.26.

⁶⁰ SSA International Update https://www.ssa.gov/policy/docs/progdesc/intl_update/2006-12/index.html access 2024.02.26.

⁶¹ Bernal (n 28) 31 & 32.

⁶² SSA International Update https://www.ssa.gov/policy/docs/progdesc/intl_update/2007-09/index.html access 2024.02.26.

⁶³ LiP, 'Poverty Decreases in Peru but Still Affects One Third of Population' Living in Peru, May 19, 2011.

⁶⁴ *Social Security* (n 13) 228.

⁶⁵ Moròn (n 48) 8.

⁶⁶ Bernal (n 28) 27.

⁶⁷ Bernal (n 28) 33.

very low balances and do not qualify for the minimum pension guarantee, and establishing early retirement options for unemployed people aged 55 to 64⁶⁸.

To help the long-term unemployed population during the global economic crisis, a new law was passed in July 2009 that allowed early retirement until the end of 2012 for SPP account holders aged 55 for men and 50 for women who had been unemployed for at least 12 consecutive months. From September 1, 2009, holders of individual accounts in Peru could choose from two new pension benefits, which are paid in two currencies - Peruvian PEN and US dollars (USD)⁶⁹. In the **mixed income** option (*renta mixta*), the balance of the individual account at the time of retirement is divided into two parts: half goes to a fund managed by the insurance company and the remaining part to the individual account managed by the pension company. The retiree receives both benefits simultaneously. The insurance company provides an annuity in USD, and the employee makes programmed withdrawals from an individual account in PEN. Under the second option, a **bi-monetary annuity** (*renta vitalicia bimoneda*), the employee purchases two annuities from one insurance company at the same time, one in USD and the other in Peruvian PEN. The employee can receive these two pensions in 12 or 14 instalments per year. In 2009⁷⁰, private sector employees were allowed to take early retirement.

On September 14, 2010, the Central Bank increased the limit for pension funds to invest abroad to 30% of total assets⁷¹. This increase, as stated in the release, was the latest in a series that began in 2006. In 2010, there were 1.73 million people over the age of 65 in Peru, representing 5.9% of the total population. Women constituted the majority in this age group - 54.1%⁷².

On July 13, 2011, the Congress of Peru raised the limit on pension funds for investments abroad from 30% to 50% of assets⁷³. On September 13, 2011, a new government program for older people was introduced, in the form of a non-contributory pension⁷⁴, called “Pensión 65” (correctly *Pensión Nacional de*

⁶⁸ SSA International Update https://www.ssa.gov/policy/docs/progdesc/intl_update/2008-12/index.html access 2024.02.26.

⁶⁹ SSA International Update https://www.ssa.gov/policy/docs/progdesc/intl_update/2009-09/index.html access 2024.02.26.

⁷⁰ *Social Security* (n 13) 228.

⁷¹ SSA International Update https://www.ssa.gov/policy/docs/progdesc/intl_update/2010-10/index.html access 2024.02.26.

⁷² Olivera Javier, Zuluaga Blanca, ‘The effects of non-contributory pensions in Colombia and Peru’ (2013), access at: https://www.researchgate.net/publication/276890625_The_effects_of_non-contributory_pensions_in_Colombia_and_Peru p. 4.

⁷³ SSA International Update https://www.ssa.gov/policy/docs/progdesc/intl_update/2011-09/index.html access 2024.02.26.

⁷⁴ This pension amounts to PEN 250 and is paid once every two months. Nowadays, it is a component of social assistance, dependent on the beneficiary’s income, but also paid to

Asistencia Solidaria), which was to be introduced in stages at the end of 2011⁷⁵. The program was to start in the five poorest regions of the country and was to be gradually expanded to the rest of the country by the end of 2013. The program was to provide a payment of PEN 250 per month to people aged 65 or over living in extreme poverty who do not receive any other government benefits.

On July 19, 2012, a new act on pension reform was passed, which introduced serious changes to the almost 20-year-old system of individual accounts in the country. The most important changes concerned⁷⁶: 1) the obligation to participate in the SNP scheme for self-employed persons with income exceeding 1.5 times the minimum wage (PEN 1,125), 2) the introduction of a social pension for employees who are over 40 years of age and earn less than this threshold and are not covered by any other pension system; the social pension was to be financed by employee contributions and government subsidies, 3) assigning new members of the labour force to the AFP with the lowest administrative fee; the selection was to be made through a tender process (taking place every two years) open to any existing or planning to enter the AFP market - the first competition was to be held by December 2012. However, the first tender was carried out in September 2012 for the fourth quarter of 2012. As a result, from October to December 2012, all new participants in the individual account system were assigned to the AFP “Prima” pension company, which offered the lowest administrative fee in the September tender⁷⁷. Moreover, in 2012⁷⁸, the system of individual pension accounts was modified and special pension rules for disabled people were introduced.

In January 2013, it was reported that in the period from February 1, 2013, to December 31, 2014, all new employees were to be assigned to the AFP “Habitat” fund, which won the tender organized by the pension funds supervisory authority in December 2012⁷⁹.

On September 16, 2014, the President signed an act that gave self-employed people the opportunity to choose between participating in SPP or SNP⁸⁰.

people of retirement age.

⁷⁵ SSA International Update https://www.ssa.gov/policy/docs/progdesc/intl_update/2011-10/index.html access 2024.02.26.

⁷⁶ SSA International Update https://www.ssa.gov/policy/docs/progdesc/intl_update/2012-08/index.html access 2024.02.26.

⁷⁷ SSA International Update https://www.ssa.gov/policy/docs/progdesc/intl_update/2012-10/index.html access 2024.02.26.

⁷⁸ *Social Security* (n 13) 228.

⁷⁹ SSA International Update https://www.ssa.gov/policy/docs/progdesc/intl_update/2013-02/index.html access 2024.02.26.

⁸⁰ SSA International Update https://www.ssa.gov/policy/docs/progdesc/intl_update/2014-10/index.html access 2024.02.26.

On January 21, 2015, a special legal regulation was introduced regarding people with severe disabilities, including the payment of new non-contributory benefits to poor disabled people, regardless of age, in the amount of PEN 125 per month⁸¹.

On April 14, 2016, the Congress of Peru overrode the presidential veto of legislation which added new withdrawal options to a privately funded scheme (SPP)⁸². The new regulations allowed SPP members, among other things, to withdraw almost all account balances (95.5%) in lump sums upon reaching the statutory retirement age (then 65) or meeting the requirements for early retirement. In addition, SPP members were able to make penalty-free withdrawals from their accounts before retirement to cover the costs of major life events, including using 25% of the account balance as security for a home purchase and 50% of the account balance in the event of terminal illness.

On May 3, 2019, Peru changed the early retirement rules for its privately funded scheme (SPP)⁸³. The reform permanently introduced the early retirement option for unemployed people (*Regimen Especial de Jubilacion*, REJA) and modified the eligibility conditions for the regular early retirement option (*Jubilacion Anticipada Ordinaria*, JAO). To qualify for early retirement under REJA, a participant must have been at least 55 years old (for men) or 50 years old (for women), had been unemployed for the last 12 months and had no self-employment income exceeding seven Reference Tax Units (*Unidad Impositiva Tributaria*, UIT). In turn, to qualify for early retirement under JAO, the participant must be at least 55 years old (for men) or 50 years old (for women) and have an account balance sufficient to purchase an annuity with payments of at least 40% of the participant's average monthly indexed earnings over the last 120 months. Additionally, voluntary contribution amounts exceeding 20% of the participant's account balance and contributions paid in the last 9 months were not taken into account when determining early retirement eligibility.

In April 2020, due to the COVID-19 pandemic, employee contributions to SPP were suspended⁸⁴. Some SPP participants were also allowed a one-time withdrawal of PEN 2,000 from their retirement accounts. The government paid non-contributory pensions from "Pension 65" in advance for 4 months. On May

⁸¹ SSA International Update https://www.ssa.gov/policy/docs/progdesc/intl_update/2015-02/index.html access 2024.02.26.

⁸² SSA International Update https://www.ssa.gov/policy/docs/progdesc/intl_update/2016-05/index.html access 2024.02.26.

⁸³ SSA International Update https://www.ssa.gov/policy/docs/progdesc/intl_update/2019-05/index.html access 2024.02.26.

⁸⁴ You can read more about the details of activities related to the COVID-19 pandemic in Peru in the context of pension issues in the dissertation Ponce Arnillas Luis Alberto Max, *Pension Reform as a Crisis Management Instrument: The case of Peru's Private Pension System reforms*, (The University of Edinburgh 2021) 27-38.

8, 2020, Peru implemented new rules allowing participants in the country's privately funded scheme (SPP) to make one-time early withdrawals from their accounts during the COVID-19 pandemic⁸⁵. The allowed withdrawal amount depended on the participant's account balance and for balances below PEN 4,300⁸⁶ it allowed the withdrawal of 100% of the accumulated resources, for balances between PEN 4,300 and PEN 17,200 an amount of PEN 4,300 (in two instalments), for balances between PEN 17,200 and PEN 51,600 at least PEN 4,300 but not more than 25% of the account balance (in two instalments), and for amounts exceeding PEN 51,600, at least PEN 4,300 but not more than PEN 12,900 (in two instalments). The participant had 60 calendar days from May 18, 2020, to submit a withdrawal request to AFP, which administers his or her individual account. On November 18, 2020, the government of Peru passed a law authorizing a second round of special payments from the private funded scheme (SPP) in response to the COVID-19 pandemic⁸⁷. By law, unemployed SPP participants could withdraw up to 4 Reference Tax Units (UIT) if they had not paid contributions in the 12-month period ending October 31, 2020, or up to 1 UIT if they had paid them in that 12-month period, but not in October 2020. From December 9, 2020, SPP participants had 90 calendar days to submit a withdrawal request to their AFP. Additionally, SPP participants diagnosed with cancer by a registered healthcare provider could withdraw up to 4 UITs from their accounts, regardless of their employment status or contribution history.

According to government estimates from March 2021, approximately 18.8% of Peruvians aged 60 or older are members of the SNP, 8.7% are members of the SPP, 6% are members of special programs, and 66.5% have no program affiliation. Peruvians who do not qualify for an SNP or SPP pension and are aged 65 or over are entitled to a social assistance pension if they are members of households classified as extremely poor. On July 22, 2021, the Government of Peru passed reforms to the national public pay-as-you-go scheme (SNP), which expanded access to the SNP early pension and introduced a special partial pension⁸⁸. The reforms aimed to improve pension security among older people who faced barriers in obtaining pension rights, especially during the COVID-19 pandemic. The changes concerned: 1) the possibility for all SNP members to receive a

⁸⁵ SSA International Update https://www.ssa.gov/policy/docs/progdesc/intl_update/2020-05/index.html access 2024.02.26.

⁸⁶ At that time, it was equivalent to 1 Reference Tax Unit (UIT).

⁸⁷ SSA International Update https://www.ssa.gov/policy/docs/progdesc/intl_update/2020-12/index.html access 2024.02.26.

⁸⁸ SSA International Update https://www.ssa.gov/policy/docs/progdesc/intl_update/2021-08/index.html access 2024.02.26.

pension from the age of 50 if they have paid contributions for at least 25 years⁸⁹, 2) the reference earnings used to calculate the benefit became the monthly covered earnings in the 60 months preceding the last month of payment contributions⁹⁰; the amount of the early retirement pension could not be lower than the minimum monthly pension of PEN 500 or higher than the maximum monthly pension of PEN 893, 3) a partial pension was introduced for people who are over 65 years old, in the amount of up to PEN 250 with contributions paid from 10 to 14 years or up to PEN 350 with contributions paid from 15 to 19 years⁹¹, and 4) restrictions on the employment of retirees have been removed - SNP retirees are no longer subject to earnings restrictions when continuing or resuming employment⁹².

According to the analysis prepared by *Superintendencia de Banca, Seguros y AFP* (SBS) in August 2022⁹³, the five special withdrawal measures implemented in 2020 and 2021 reduced SPP assets by 65.9 billion PEN and left 2.3 million participants (or about 28.5 percent of total active participants) without any retirement savings.

Key Reforms and Their Impacts

Year	Reform	Impact
1992	Introduction of individual pension accounts (SPP) alongside SNP	Shift from public PAYG to private funded schemes; increased competition
2002	Implementation of guaranteed minimum pension in SPP	Enhanced financial security for low-income retirees in SPP
2012	Mandatory participation of self-employed in SNP; new social pension introduced	Increased coverage of pension system, addressing informal sector issues
2020	COVID-19 pandemic-related measures allowing mass withdrawals from SPP	Significant reduction in retirement savings; risk to long-term system stability

⁸⁹ Previously, only women could receive a pension at the age of 50 by paying at least 25 years of contributions; men had to wait until age 55 and have at least 30 years of contributions to take early retirement unless they qualified for a special early retirement pension.

⁹⁰ Previously, the reference salary formula varied depending on the insured person's date of birth and years of contributions.

⁹¹ Previously, an SNP member had to pay at least 20 years of contributions to qualify for a partial pension.

⁹² Previously, SNP pensioners could only work if their monthly earnings did not exceed half of the Reference Tax Unit (UIT - 1 UIT is currently PEN 5,150). Compare: Estado Peruano <https://www.gob.pe/institucion/mef/pages/435-valor-de-la-uit-en-el-ano-2024> access 2024.02.26.

⁹³ SSA International Update https://www.ssa.gov/policy/docs/progdesc/intl_update/2022-09/index.html access 2024.02.26.

IV. CURRENT STATE OF THE PENSION SYSTEM IN PERU - AS OF JANUARY 1, 2024

The Peruvian pension system consists of two main components⁹⁴. Public and private sector employees entering the workforce can choose between a public pay-as-you-go scheme (*Sistema Nacional de Pensiones, SNP*) and a mandatory individual account scheme (*Sistema Privado de Pensiones, SPP*). Insured persons who have not made a choice become SPP members by default. SNP members can transfer later to SPP, but SPP members can only transfer to SNP if certain conditions are met. SPP members include public and private sector employees. Insurance is voluntary for self-employed people. In contrast, SNP covers private sector workers and public sector workers not covered by the SPP system, including by default workers in employee and cooperative enterprises, teachers, artists, domestic workers, sailors, journalists and tannery workers. Self-employed people and housewives can participate on a voluntary basis. Special pension schemes are provided for fishermen, diplomats, certain public sector employees (*cedula viva*) and military and police personnel. The Peruvian state offers two non-contributory pensions to vulnerable elderly people who have not contributed to a pension fund or whose contributions do not allow them to have a sufficient pension to live on: the Minimum Old Age Pension (*Pensión Mínima de Vejez*) and the National Solidarity Relief Pension “Pension 65” (*Pensión Nacional de Asistencia Solidaria, “Pensión 65”*)⁹⁵.

In the case of **SNP** employees, contributions are paid only by the employee and amount to 13% of gross monthly earnings. There are minimum monthly earnings used to calculate contributions, and this is the statutory minimum wage, which is PEN 1,025. The government provides subsidies to the system if they are needed to maintain financial liquidity. The SNP scheme can be considered a solution using the insurance method due to the presence of a premium as a source of financing and a common risk fund.

In the case of self-employed people, contributions amount to 13% of the declared income. The minimum monthly income used to calculate contributions is the statutory minimum wage, which is PEN 1,025. There is no limit on the maximum income taken to calculate the contribution amount.

Pension from **SNP** (*Pensión de Jubilación, SNP*) is paid upon reaching the age of 65 with at least 20 years of contributions. Employment may continue if the monthly sum of the insured’s income does not exceed half of the Reference Tax

⁹⁴ *Social Security* (n 13) 228.

⁹⁵ Lavigne (n 18) 14.

Unit (UIT)⁹⁶, which is PEN 5,150 per year. SNP pension is payable abroad on the basis of a bilateral or multilateral agreement. The pension is:

- **for a person born after December 31, 1946**, 30% to 45% of the insured person's average monthly salary over the last 60 months, depending on the insured person's age on June 14, 2002 (30% for those under 31 years of age, 35% for those over 31 to 39 years of age, 40% for those aged 40 to 49 years and 45% for persons older than 49 years) **plus 2%** of average monthly earnings for each year of contribution exceeding 20 years;
- **men born after December 18, 1932, and women born after December 18, 1937, but before January 1, 1947**, are entitled to 50% of the insured person's basic salary plus 4% of the basic salary for each contribution year over 20 years; when paying contributions for 20-24 years, the base salary is the insured person's average monthly earnings from the last five years, with contributions paid for 25 to 30 years, the average monthly earnings from the last four years, and in the case of people with more than 30 years of contributions, the average monthly earnings over the last three years;
- **men born before December 18, 1932, and women born before December 18, 1937**, are paid 50% of the basic salary plus 2% of the basic salary (men) or 2.5% (women) for each year of paying contributions over 15 years (men) or 13 years (women); base salary is the insured person's average monthly earnings over the last 12, 36 or 60 months, whichever is higher.

Age 50 is required for **early retirement** (*Jubilación anticipada*) with SNP if participants have been contributing for at least 25 years. Early retirement pension is reduced by 4% for each year of early retirement before reaching the statutory retirement age.

You may also receive **Dependent Allowance**, paid to your dependent spouse or child under 18 (no age limit if student or disabled). Dependent's allowance is 2% to 10% of the insured person's reference salary paid to an eligible spouse and 2% to 5% to each eligible child.

The minimum monthly pension is PEN 500. The maximum monthly pension is PEN 893⁹⁷ or 100% of the insured person's average monthly earnings over the last 60 months, whichever is lower.

All benefits are adjusted periodically depending on the financial resources of the system.

In addition, **a family pension** (*Pensión Especial de Jubilación para la Sociedad Conyugal y las Uniones de Hecho*, SNP) may be paid from the SNP to

⁹⁶ Estado Peruano <https://www.gob.pe/institucion/mef/pages/435-valor-de-la-uit-en-el-ano-2024> access 2024.02.26.

⁹⁷ Estado Peruano <https://www.gob.pe/516-elegir-sistema-de-pensiones-sistema-nacional-de-pensiones-snp> access 2024.02.26.

a couple whose members are both at least 65 years of age, have been married or in a recognized partnership for at least 10 years and have at least 20 years of total National Insurance contributions but are not eligible for a Social Security Pension. Family pension ends on divorce, remarriage or dissolution of a recognized partnership. Family pension is paid abroad under a bilateral or multilateral agreement. Calculated in the same way as the SNP pension, based on the couple's shared basic salary. The full amount of the Joint Monthly Survivor Pension continues to be paid to the surviving beneficiary after his partner's death.

In **SPP**, in the case of hired workers, the contribution is paid by employees and amounts 10% of gross remuneration (8% for fishermen; 11% for construction workers; 2% for miners) plus allowances, and by employers, contributions are paid only for the following professional groups: 5% for fishermen, 1% for construction workers and 2% for miners. The government finances the value of rights accrued under SNP in the event of a transfer of an existing SNP participant to SPP. It is also possible to pay additional voluntary contributions. There are no specific maximum earnings used to calculate pension contributions. However the maximum monthly earnings are used to calculate contributions in the case of disability insurance - this amount is PEN 10,535⁹⁸. Basically, this scheme can be classified as a solution using the investment method with elements of the supply from budget funds method.

For self-employed people, contributions are 10% of the value of declared income plus a certain percentage of income (for administrative fees) and 1.35% of monthly insured income (disability and family insurance). The percentage of pension contributions is regulated by law; administrative fee percentages and disability and survivors' insurance contributions are determined by the AFP. There are no specific maximum incomes used to calculate pension contributions. However, the maximum monthly income is used to calculate contributions in the case of disability insurance - this amount is PEN 10,535.

Pension from SPP (*Pensión de Jubilación*, SPP) is paid to participants of the scheme when they reach the age of 65 without any additional conditions. There are 4 AFPs on the market⁹⁹. The insured has five different retirement payment options: 1) to make programmed withdrawals, 2) to purchase a personal annuity, 3) to purchase a joint annuity and survivor annuity, 4) to purchase a deferred annuity in combination with periodic programmed withdrawals, or 5) to make a lump sum payment of 95.5 % of the total account balance. If the insured person chooses a lump sum payment, the remaining 4.5% finances medical services.

⁹⁸ ANDINA <https://andina.pe/agencia/noticia-seguro-invalides-y-sobrevivencia-es-y-como-activar-las-coberturas-878226.aspx> access 2024.02.26.

⁹⁹ They were AFPs: Integra, Profuturo, Habitat & Profuturo. Compare: AAFPa, <http://estadisticas.asociacionafp.pe/ActiveAffiliatesAccordingAfp> access 2024.02.26.

Early retirement (*Jubilación anticipada*) from **SPP** (*Jubilación anticipada ordinaria*) is paid to people who have reached the age of 55 (men) or age 50 (women) with at least 72 months of contributions in the last 120 months before applying and the account balance is sufficient to finance a benefit of at least 40% of the insured person's average indexed earnings over the last 120 months. The withdrawal options are the same as for a pension paid when you reach normal retirement age.

Early unemployment pension (*Jubilación anticipada por desempleo*) is paid to people with at least 12 uninterrupted months of unemployment when they reach the age of 55 (men) or 50 (women).

Early retirement for persons working in hazardous conditions (*Jubilación anticipada por labores de riesgo*) is available from the age of 40 to 50, depending on the occupation, subject to further specific requirements.

The Guaranteed Minimum Pension is only available to people born before January 1, 1946, who have at least 20 years of paid contributions on earnings equal to or greater than the statutory minimum monthly wage, and whose account balance is insufficient to fund the minimum monthly pension prescribed by law. The legal monthly minimum wage is PEN 1,025. The guaranteed minimum pension is paid to PEN 500. The Guaranteed Minimum Pension is paid as a benefit resulting from the difference between the monthly pension financed from the individual account balance and the amount of PEN 500.

Pension from an individual account is payable abroad on the basis of a bilateral or multilateral agreement.

Comparison of SNP and SPP

Criteria	SNP (Public PAYG)	SPP (Private Funded)
Funding Source	Employee contributions (13%) + state subsidies	Employee contributions (10%) + investment returns
Retirement Age	65 (both genders)	65 (early retirement possible with conditions)
Pension Calculation	Based on average salary over last 60 months	Based on individual account balance
Tax Treatment	No tax incentives; pensions taxed	No tax incentives; pensions taxed
Impact of 'Black Swans'	Limited due to state guarantee, but fiscal pressure increases	High vulnerability due to possibility of mass withdrawals

V. CHALLENGES AND ANTICIPATED CHANGES IN PERU'S PENSION SYSTEM

The most important challenge facing the pension system in Peru seems to be the dissemination of the scale of participation in pension solutions. In the fourth quarter of 2021, only 35.3% of the elderly population were covered by any pension scheme, of which 19.5% were linked to the SNP, 10.2% were linked to the SPP, and 2.9% were linked to the government *cédula viva*¹⁰⁰. The justification for such low participation of the population in pension solutions is mainly found in the alarming scale of the “gray” and “black” economy in Peru in international comparisons¹⁰¹. Nowadays, it is estimated that its scale has decreased from 61% in 1993 to over 41% in 2015¹⁰², but reducing its scale is still a serious challenge for the authorities. Similarly, the scale of social inequalities in Peru has decreased significantly - the GINI coefficient decreased from over 55% in 1998 to 43.8% in 2020¹⁰³, but in international comparisons, it is still a very high value and a challenge for the government. There are interesting proposals to introduce a pillar structure in Peru's pension system, such as that presented by the Peruvian Association of Pension Companies (*La Asociación de Administradoras de Fondos de Pensiones, AAFP*)¹⁰⁴ or the four-pillar concept proposed by Mesa-Lago¹⁰⁵. It seems that the changes should also concern the areas of greater efficiency in collecting pension contributions (in 2004 it was only 44%¹⁰⁶) and the introduction of tax reliefs related to the payment of pension contributions (Peru remains one of the few countries that does not offer any tax reliefs for people paying pension contributions). All these demands may be valid given the favorable changes in the state of the Peruvian economy.

Long-Term Impact of Reforms on the Stability of the Peruvian Pension System

The Peruvian pension system has undergone multiple reforms since the 1990s, each with distinct implications for its long-term financial stability. While

¹⁰⁰ INEI, ‘Situación de la Población Adulta Mayor’ (Instituto Nacional de Estadística e Informática 2022), access at: <https://www.inei.gob.pe/media/MenuRecursivo/boletines/01-informe-tecnico-poblacion-adulta-mayor-oct-nov-dic-2021.pdf> access 2024.02.26.

¹⁰¹ Ramos (n 26).

¹⁰² TGE, https://www.theglobaleconomy.com/Peru/shadow_economy/ access 2024.02.26.

¹⁰³ FRED, <https://fred.stlouisfed.org/series/SIPOVGINIPER> access 2024.02.26.

¹⁰⁴ AAFPb, <https://www.asociacionafp.pe/reforma-pensiones/> access 2024.02.26.

¹⁰⁵ Mesa-Lago Carmelo, ‘Suggestions for Pension Re-Reform in Peru’, Centro de Investigación de la Universidad del Pacífico, Apuntes 78, First Semester 2016.

¹⁰⁶ Ramos (n 26).

these reforms aimed to address emerging economic, demographic, and political challenges, they have also introduced vulnerabilities that could undermine the system's sustainability.

Impact of Structural Reforms on Financial Sustainability

- **Shift from Public PAYG to Private Funded Schemes (1992 Reform):** The introduction of the privately funded scheme (SPP) aimed to diversify retirement income sources and reduce the fiscal burden on the state. However, the coexistence of both systems (SNP and SPP) has created **fragmentation**, leading to administrative inefficiencies and increased management costs. The need to finance both systems simultaneously strains public finances, especially as SNP remains dependent on government subsidies due to demographic shifts and declining contribution ratios.
- **Implementation of the Guaranteed Minimum Pension (2002 Reform):** While this measure enhanced social protection for low-income retirees, it also imposed **long-term fiscal obligations** on the government. The absence of dedicated funding mechanisms for this guarantee increases the risk of future budgetary pressures, especially in the face of economic downturns.

Vulnerability to Economic Shocks and External Crises

- **Mass Withdrawals During the COVID-19 Pandemic (2020):** The government's decision to allow mass withdrawals from individual pension accounts during the COVID-19 pandemic highlighted the **fragility of the privately funded scheme**. While these withdrawals provided short-term financial relief, they **depleted retirement savings** for millions of Peruvians, compromising the adequacy of future pensions and increasing the likelihood of retirees relying on state-funded safety nets.
- **Lack of Resilience Mechanisms:** The Peruvian pension system lacks built-in mechanisms to mitigate the effects of economic shocks. For instance, there are no robust automatic stabilizers, such as counter-cyclical funding reserves, to buffer the impact of crises on pension fund performance and liquidity.

Demographic Challenges and Informal Labor Market

- **Demographic Shifts:** Although Peru currently enjoys a relatively young population, **aging trends** are expected to accelerate in the coming decades. This demographic shift will lead to a **higher dependency ratio**, placing

additional strain on the SNP, which relies on contributions from the active workforce to finance current pensions.

- **High Informality Rates:** The **large informal sector** limits the contribution base for both SNP and SPP. Without comprehensive reforms to address informality, the pension system will continue to face **coverage gaps** and insufficient contribution inflows, undermining its long-term viability.

Policy Recommendations to Enhance Long-Term Stability

- **Diversification of Funding Sources:** Introduce policies to encourage **voluntary pension savings** and diversify funding mechanisms, reducing reliance on a single source of contributions.
- **Establishment of Crisis-Response Mechanisms:** Create a **reserve fund** specifically designed to provide liquidity during economic crises, preventing ad-hoc measures like mass withdrawals that erode retirement security.
- **Integration of Informal Workers:** Implement incentives, such as **tax benefits or matching contributions**, to integrate informal workers into the formal pension system, thereby expanding the contribution base.
- **Regular Review of Retirement Age and Contribution Rates:** Adjust the **statutory retirement age** and **contribution rates** in response to demographic trends to maintain a balanced dependency ratio and ensure fiscal sustainability.

VI. CONCLUSION

The pension system in Peru is undoubtedly different from most countries, which adopt a multi-pillar concept or separate schemes dedicated to specific professional groups. The solution adopted in this country provides for direct competition between the public and private schemes for the resources of the same participants. The evolution of private pension funds in Peru has been seriously affected by unfair competition between the private and public pillars. Initially, lower contribution rates and lower retirement ages for entities affiliated with the public pillar significantly reduced the attractiveness of private pension funds at the very beginning of the system reform. However, since 1995, after equalizing the input parameters, the private scheme has gained a significant advantage over the public scheme. After equalizing the operating conditions, pensions paid from SPP became significantly higher than benefits from SNP¹⁰⁷. However, the pandemic problems of recent years have reversed the preferences of many

¹⁰⁷ Already in 2005, it was estimated that the average SPP pension was 75% higher than the SNP benefit with the same parameters in terms of participation time. Compare: Ramos (n 26).

Peruvians, and according to the latest data, almost twice as many of the elderly participated in the SNP than in the SPP¹⁰⁸. Of the latter, 95% of those retiring use the option of a one-off payment of 95.5% of the resources accumulated in their retirement account, available since 2016¹⁰⁹.

Due to the presence of a premium as a source of financing and a common risk fund, the SNP scheme can be considered a solution using the insurance method. However, it should be noted that the insurance method is supplemented in many partial elements by the supply from budget funds method. However, the SPP scheme is an example of using the investment method, also supplemented with the supply from budget funds method. The hypothesis that the insurance method, permanently present in the Peruvian pension system, is decreasing its importance in favour of the investment and supply from budget funds methods was confirmed.

The actions taken by the Peruvian authorities twice in 2020, caused by the COVID-19 pandemic, enabling in the case of some participants to withdraw from the SPP scheme up to 100% of the resources accumulated over the years on individual pension accounts, are a vivid confirmation of the hypothesis put forward at the beginning that the influence of “black swans” on human behaviour, may lead to the complete annihilation of resources accumulated with rational justification, intended for retirement purposes.

Policy Recommendations for Enhancing the Peruvian Pension System

To improve the sustainability and effectiveness of Peru’s pension system, the following key policy measures are recommended:

Strengthen Financial Sustainability:

- Diversify funding sources beyond employee contributions.
- Gradually raise the retirement age in line with increasing life expectancy.
- Establish a stabilization fund to cushion the impact of economic crises.

Expand Coverage:

- Introduce incentives for formal employment and participation in pension schemes.
- Implement flexible contribution options for informal workers.
- Apply automatic enrollment with an opt-out option to increase participation rates.

¹⁰⁸ INEI (n 100).

¹⁰⁹ Poblete Miranda Hernán, *Spotlight on Retirement: Peru 2019* (LIMRA and LOMA Secure Retirement Institute, Society of Actuaries 2020) 24.

Improve Pension Adequacy:

- Adjust the minimum pension to reflect the cost of living.
- Expand non-contributory pensions for vulnerable groups.
- Address gender disparities through credits for caregiving periods.

Enhance Governance:

- Strengthen oversight of pension fund administrators (AFPs).
- Promote financial literacy to support informed retirement planning.

These measures aim to create a more inclusive, resilient, and financially stable pension system capable of adapting to future economic and demographic challenges.

References

A Li and J Olivera, 'Participation in the Peruvian reformed pension system' (2005) <https://core.ac.uk/download/pdf/9066547.pdf> accessed 26 February 2024.

AAFP, <http://estadisticas.asociacionafp.pe/ActiveAffiliatesAccordingAfp> accessed 26 February 2024.

AAFP, <https://www.asociacionafp.pe/reforma-pensiones/> accessed 26 February 2024.

ANDINA, <https://andina.pe/agencia/noticia-seguro-invalides-y-sobrevivencia-es-y-como-aktivar-las-coberturas-878226.aspx> accessed 26 February 2024.

N Bernal et al, 'A look at the Peruvian Pension System: Diagnosis and Proposals', (BBVA 2008) Pension Studies Series.

Bloomberg, <https://www.bloomberg.com/markets/currencies/cross-rates> accessed 26 February 2024.

CIA, <https://www.cia.gov/the-world-factbook/countries/peru/#people-and-society> accessed 26 February 2024.

countryeconomy.com, <https://countryeconomy.com/national-debt/peru> accessed 26 February 2024.

Decreto Ley 25897 (1992) del 6 de diciembre de 1992.

Decreto Ley N° 19990 (1973), 30 de abril de 1973 Se crea el Sistema Nacional de Pensiones de la Seguridad Social, https://cdn.www.gob.pe/uploads/document/file/251495/226861_file20181218-16260-fwxiyt.pdf accessed 26 February 2024.

Estado Peruano, <https://www.gob.pe> (2024).

FRED, <https://fred.stlouisfed.org/series/SIPOVGINIPER> accessed 26 February 2024.

INEI, 'Situación de la Población Adulta Mayor' (Instituto Nacional de Estadística e Informática 2022) <https://www.inei.gob.pe/media/MenuRecursivo/boletines/01-informe-tecnico-poblacion-adulta-mayor-oct-nov-dic-2021.pdf> accessed 26 February 2024.

M Lavigne, Social protection systems in Latin America and the Caribbean: Peru, (Economic Commission for Latin America and the Caribbean (ECLAC) 2013).

LiP, 'Poverty Decreases in Peru but Still Affects One Third of Population' Living in Peru, 19 May 2011.

C Mesa-Lago, 'Suggestions for Pension Re-Reform in Peru', Centro de Investigación de la Universidad del Pacífico, Apuntes 78, First Semester 2016.

E Moròn, 'The Peruvian Pension Reform', (2007) Documento de Discusión DD 07/04, Centro de Investigación de la Universidad del Pacífico.

W Muszalski, *Ubezpieczenie społeczne. Podręcznik akademicki* (Wydawnictwo Naukowe PWN 2006).

NBP, <http://www.nbp.pl/home.aspx?f=/kursy/kursyb.html> accessed 26 February 2024.

J Olivera and B Zuluaga, 'The effects of non-contributory pensions in Colombia and Peru' (2013) https://www.researchgate.net/publication/276890625_The_effects_of_non-contributory_pensions_in_Colombia_and_Peru accessed 26 February 2024.

H Poblete Miranda, *Spotlight on Retirement: Peru 2019* (LIMRA and LOMA Secure Retirement Institute, Society of Actuaries 2020).

LAM Ponce Arnillas, *Pension Reform as a Crisis Management Instrument: The case of Peru's Private Pension System reforms*, (The University of Edinburgh 2021).

J Poteraj, 'Metoda ubezpieczeniowa w zarządzaniu ryzykiem starości' (2011) in: *Ubezpieczenia gospodarcze i społeczne. Wybrane zagadnienia ekonomiczne*, Ed. by Wanda Sułkowska, (Oficyna a Wolters Kluwer business 2011) 183-195.

J Poteraj, 'Pension Concepts in Europe - from Otto von Bismarck to the OMC' OPTIMUM. *Studia Ekonomiczne* nr 3 (39), (Uniwersytet w Białymstoku 2008) 199-218.

J Poteraj, 'Wykorzystanie metody ubezpieczeniowej w systemie emerytalnym Austrii' (2013), in: *Rynek ubezpieczeń. Współczesne problemy* Ed. by Wanda Sułkowska, (Difin 2013) 344-354.

M Queisser, 'Pension Reform and Private Pension Funds in Peru and Colombia', The World Bank, Policy Research, Working Paper 1853, Financial Sector Development Department, November 1997.

J Ramos, 'Dual system in Peru still finding its feet', *Global Pensions* February 2005.

Social Security Programs Throughout the World: The Americas, 2019, (Social Security Administration 2020), Office of Retirement and Disability Policy & Office of Research, Evaluation, and Statistics, SSA Publication No. 13-11804, Released: March 2020, Washington, DC.

SSA International Update (various issues), US Social Security Administration, 2003 through 2022 <https://www.ssa.gov/policy/research.html?sort=date&keyword=peru> (2024).

D Stańko, 'Doświadczenia we wprowadzaniu wielofunduszowości w innych krajach' (2010a), in: *Wielofunduszowość w systemie emerytalnym*, Ed. by Aleksandra Wiktorow and Bohdan Wyżnikiewicz, (Instytut Badań nad Gospodarką Rynkową 2010) 24-44.

D Stańko, 'Transfery członków kapitałowych funduszy emerytalnych na świecie i w Polsce. Analiza racjonalności decyzji członków OFE' (2010b), „*Rozprawy Ubezpieczeniowe*” Zeszyt 8(1/2010) 7-36.

T Szumlicz, *Ubezpieczenie społeczne. Teoria dla praktyki* (Oficyna Wydawnicza Branta 2006).

TGE, https://www.theglobaleconomy.com/Peru/shadow_economy/ accessed 26 February 2024.

TWB, 'Peru's Private Pension System: An Analysis of its Evolution, Current Market Structure and Recommendations for Reform', The World Bank, Finance, Private Sector and Infrastructure Department, Latin America and the Caribbean Region, July 2003.

TWBI, <https://data.worldbank.org/indicator/NY.GDP.PCAP.PP.CD?locations=PE> accessed 26 February 2024.

Wielka Encyklopedia PWN, (Wydawnictwo Naukowe PWN 2004), v. 20.