



## PENSION NOTES

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### Mexico: Proposed Changes to the Pension Savings System Law

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#### EXECUTIVE SUMMARY

On January 23, the Executive Branch, submitted a bill of law through the Ministry of Finance (Parliamentary Gazette, 2019) that amends several articles of the Pension Savings System Law (LSAR).

The most relevant changes are as follows:

- i) Transformation of the "Specialized Pension Fund Investment Companies" (SIEFORES) to "Investment Funds Specializing in Pension Funds;"
- ii) Greater flexibility of the investment regime;
- iii) Incorporation of returns in the design of the fee collection system;
- iv) Easier access to voluntary savings for workers.

Since the costs of the creation of additional Investment Funds are marginal compared to those incurred in the case of the SIEFORES, the AFORES would be able to open the necessary number of funds to migrate to a Target Date Funds (TDF) system, or "Life Cycle Funds," which seems to be the new government's intention, due to the benefits it entails.

In principle, the proposed changes could benefit workers through the obtainment of higher returns, greater liquidity and facilitating the use of part of the invested funds. However, the true impact of this reform will be assessed in the secondary regulations.

#### INTRODUCTION

The Mexican Chamber of Deputies recently published a bill of law submitted by the Executive that proposes reforming several provisions of the Pension Savings System Law (LSAR). The bill of law is currently in the Chamber of Deputies, and will move to the Senate at a later date.

This initiative is not a reform of the pension system as such, since it does not seek to modify the parameters of the system (such as the retirement age or the mandatory contribution rate to individual accounts), but rather to enable the pension fund managers (AFORES) to expand their investment options, thereby increasing the returns they offer to workers.

The purpose of this Pension Note is to describe the most significant changes proposed in the bill of law.

## THE BILL OF LAW AND THE MAIN CHANGES PROPOSED

### 1. Change of legal status to Investment Funds.

The AFORES will invest through Investment Funds Specializing in Pension Funds (FIEFORES) and no longer through the Investment Companies Specializing in Pension Funds (SIEFORES), as is currently the case.

According to this bill of law, the purpose of the FIEFORES is to invest the funds they receive from the individual accounts in accordance with the social security laws and the Pension Savings System (PSS) Law.

This will, in principle, enable simplifying processes and reducing the cost of its constitution, authorization, operation and organization. For example:

- As an exception to the General Company Law, these Investment Funds will not have shareholders' meetings, a board of directors or a shareholders' representative. Corporate governance will depend directly on the Council of the AFORES.
- The Investment Funds will be incorporated by a single founding partner before the National

Commission for the Retirement Savings System (CONSAR) without having to submit their Articles of Incorporation, Bylaws, or their registration in the Public Commercial Registry to a notary public or broker.

The SIEFORES must publish closing prices in any of the authorized Stock Exchanges (BMV<sup>1</sup> or BIVA<sup>2</sup>) which also incurs very high costs. With the proposed change, the FIEFORES can publish prices on other platforms, provided they are daily publications that are freely accessible to the public (e.g. Bloomberg).

### ***Current functioning of the SIEFORES***

Under the existing regulations, the AFORES must mandatorily invest pension savings contributions in four different Basic SIEFORES, based on the age brackets of members. The portfolio mix of each SIEFORE is differentiated by its limit of exposure to risky assets, especially investment limits in equities or structured instruments.<sup>3</sup> Workers must remain for a certain period of time, and migrate to a lower risk SIEFORE as they age (see Table 1). These migrations or "transfers" due to aging give rise to asset purchases that are not necessarily efficient. SIEFORE-type funds are usually called "Target Risk Funds."

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<sup>1</sup> Mexican Stock Exchange.

<sup>2</sup> Institutional Securities Exchange.

<sup>3</sup> This refers to: Development Capital Certificates (CKDs), Real Estate Investment Trusts (FIBRAS), Investment Project Certificates (CERPIS), and

Infrastructure Investment Trusts (FIBRA-E). For further details, please see Pensions Note No. 32 "[Pension Fund Investment in alternative assets: Chile and Mexico](#)".

**Table 1**  
**Mexico: Default assignment criteria in SIEFORES**

Members age	
Age Bracket	Default fund
Members up to 36	Basic Siefore 4 (up to 45% in Equities)
Members between 37 and 45	Basic Siefore 3 (up to 35% in Equities)
Members between 46 and 59	Basic Siefore 2 (up to 30% in Equities)
Members aged 60 or more	Basic Siefore 1 (up to 10% in Equities)

Note: Members are not allowed to choose a more aggressive fund than the one assigned by default. Members are automatically switched to more conservative funds as they age, although they can switch to a more conservative fund than the one assigned by default.

***Migration to a Life Cycle Funds system***

The operating and economic costs of creating additional Investment Funds are marginal compared to those incurred in the case of the SIEFORES. This last point would allow the AFORES to be able to open the necessary number of funds to migrate to a Target Date Funds (TDF), or "Life Cycle Funds" system, which seems to be the new government's intention, due to the benefits it entails.

According to CONSAR (2018), the TDFs are investment funds that re-balance their allocation of risk assets as workers in age bracket "X" approach retirement, based on a strategy pre-established by the fund manager. In this model, instead of workers migrating between funds with increasingly smaller risk-weighted assets, the fund itself modifies its exposure to risk assets. In other words, in the TDF model, the investment fund slowly migrates with the worker in a seamless, long-term trajectory, from a high-risk to a conservative profile.

Some of the advantages of this model:

- It allows members to dispense with a multiplicity of variables that define their risk profile, focusing on one only: their age.
- By not requiring the transfer of members' resources from one fund to another, possible intermediation costs (purchase-sale) and the risk of illiquidity in the markets, derived from the liquidation of instruments, are avoided.

**2. It has been proposed that CONSAR, with the prior approval of the Ministry of Finance and Public Credit (SHCP) and the Bank of Mexico (BM), should determine the investment regime of the AFORES.**

The Statement of Purpose of the bill of law proposes improving the portfolio mix of the AFORES, in terms of coverage by instruments, sectors and markets, in order to enable achieving better returns of the managed funds and, consequently, better pensions for workers, by allowing the regulatory and supervisory authority, CONSAR, to modified the investment

regime that AFORES are subject to, with prior approval of the SHCP (Ministry of Finance and Public Credit) and the BM (Bank of Mexico).

The purpose of this modification is to eliminate the political factor and the term required for legislative amendments of the pension fund investment regime, avoiding having to go to Congress every time changes are required, making the system more flexible.

In CONSAR's new investment regime, greater investment options will be allowed for increasing liquidity and the returns offered to workers. According to the bill of law, the FIEFORES may initially:

- Receive deposits constituting guarantees in repo transactions.<sup>4</sup>;
- Receive loans comprising securities and hedging financial instruments;
- Purchase international securities (within the investment regime and limits authorized by CONSAR, eliminating the 20% limit stipulated in the existing law);
- Carry out credit transactions, as well as securities lending and the sale and repurchasing of securities other than government or bank securities, or bank-guaranteed securities, as in the past.
- Perform short-term transactions with guaranteed securities (provided they were received as a securitization pledge with transfer of ownership).

In the purchase of foreign securities, it has been proposed to include a section requiring information on the percentage of the portfolio of each Investment Fund invested in these types of securities, the countries and currencies in which they were issued, and a detailed analysis of the effect of these investments on the returns of the funds.

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<sup>4</sup> Repo transactions are common in the debt market. In these transactions, the seller (intermediary) sells the buyer (investor), credit documents at their current price, with the commitment to buy back the same volume prior

The prohibition of investing in primary issues of public or private offers of the securities of companies over which the fund manager has administrative control, with equity links, or that are part of the same financial or business group to which they belong, is maintained.

**3. The inclusion of a new commission in favor of the AFORES has been proposed - additional to the existing commission on the balance of the funds managed in the Individual Account - to the expense workers, and calculated on the basis of the returns obtained on the investment of their funds in the Investment Funds, through the methodology authorized by CONSAR's Board of Directors.**

Thus, it is being proposed that the commission charged by the AFORES be divided into two components:

- a. Commission on the balance: The commission currently being charged. The new government has commented that it aims to reduce this commission to 70 basis points by the end of this six-year term (the average commission of the system is currently 98 basis points).
- b. Commission on performance: The primary purpose of this commission is to better align the incentives of workers and the AFORES. This commission will be charged on a reference or "benchmark" to be surpassed, serving as a reference for the strategy that the AFORES must abide by. This reference will be reviewed by the country's different authorities (MFPC and BM) and work groups, including the private sector, may participate in its creation.

to their expiration and at the same purchase price, plus a fee paid by the buyer, equivalent to a rate of return for the number of days of the transaction.

The reference will be based on long-term investment principles and the maximization of a certain level of replacement rate, in order to avoid short-term outlooks by asset managers. This reference will be a first step in migrating to the TDF or Life Cycle Funds system.

**4. It has been proposed to make the conditions for withdrawals from voluntary contribution sub-account funds more flexible, eliminating existing requirements on the permanence of said savings for a specified period of time.**

The initiative eliminates the mandatory restrictions on withdrawals of the voluntary contributions of workers, limited only to what is stipulated in the prospectus of each investment fund.

Workers can currently withdraw from their voluntary contribution sub-accounts within the period stipulated in the prospectus of each investment company, which cannot be less than two months.

## **ASSESSMENT OF THE INITIATIVE**

In principle, the proposed changes could benefit workers through the obtainment of higher returns, greater liquidity and facilitating the use of part of the invested funds.

It could also be positive for the financial system, since by diversifying the investment alternatives of the pension funds, the available loanable funds can be increased, especially for private companies, thus contributing to deepening the financial system. However, the true impact of this reform will be assessed in the secondary regulations.

Finally, if the aim is to move towards a Life Cycle Funds system, special attention must be paid to the secondary regulations. As the current bill of law is drafted, workers could invest their funds in more than one FIEFORE, but this is not consistent with a traditional TDF design, where there should be a set of Feeder Funds per asset class, and the portfolio of each cohort or age group moves along a glide-path or predetermined investment trajectory based on the life cycle.

## **Bibliographical references**

CONSAR (2018). What are Target Date Funds? International experiences and possible benefits. <https://www.gob.mx/cms/uploads/attachment/file/345344/TDF.pdf>

Parliamentary Gazette (2019). Number 5203-III. Published on January 23, 2019. Initiative of the Federal Executive with draft ordinance, by which several provisions of the Pension Savings System Law are amended, added and repealed. Available on the [Internet](#).

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