amafore

Asociación Mexicana de Administradoras de Fondos para el Retiro

# Mexican pension funds system

## Background, current situation and major challenges


**XXV Annual IIFA Conference**

Stockholm, Sweden

September 20, 2011

# Outline

I. Background

II. Current situation

III. Main challenges

# I. Background

## I.1 Outstanding cases of DB to DC reforms since the 1980s

| | | Type of system | | |
|---|---|---|---|---|
| Country | year | Unique | integrated | in competition |
| **Latin America** | | | | |
| Chile | 1981 | • | | |
| Peru | 1993 | | | • |
| Colombia | 1994 | | | • |
| Argentina+ | 1994 | | | • |
| Uruguay | 1996 | | • | |
| Bolivia | 1997 | • | | |
| Mexico | 1997 | • | | |
| El Salvador | 1998 | • | | |
| Costa Rica | 2000 | | • | |
| Panama | 2002 | | | |
| Dominican Republic | 2003 | • | | |
| **Central & Eastern Europe** | | | | |
| Hungary+ | 1998 | | • | |
| Poland | 1999 | | • | |
| Sweden | 1999 | | • | |
| Latvia | 2001 | | • | |
| Bulgaria | 2002 | | • | |
| Croatia | 2002 | | • | |
| Estonia | 2002 | | • | |
| Kosovo | 2002 | • | | |
| Russian federation | 2003 | | • | |
| Lituania | 2004 | | • | |
| Slovakia | 2005 | | • | |
| Macedonian | 2006 | | • | |
| Czech Republic | * | | | |
| Rumania | 2008 | | • | |
| Ukraine | ** | | | |
| **Asia** | | | | |
| Kazajstan | 1998 | • | | |
| Brunei | 2010 | | • | |
| Armenia | * | | | |
| **Africa** | | | | |
| Nigeria | 2005 | • | | |
| Ghana | 2010 | | • | |

Source: FIAP
+ Reversed
* not yet approved
** not yet implemented

# I. Background

## I.2 Main common features

- Replacement of traditional, “pay as you go”, DB schemes by DC models
- Mandatory
- Individual accounts
- Fully funded
- Close link between contributions and benefits
- Private management by specialized firms
- Transitional measures (recognition of acquired rights)
- Guarantees (minimum pension and/or rate of return)
- Government regulation and supervision

# I. Background

## I.3 The Mexican case

- The two largest pension schemes in Mexico date back to the 1920´s (government employees) and the 1940’s (private sector employees)
- In 1997 the latter was reformed, while the former followed in 2007

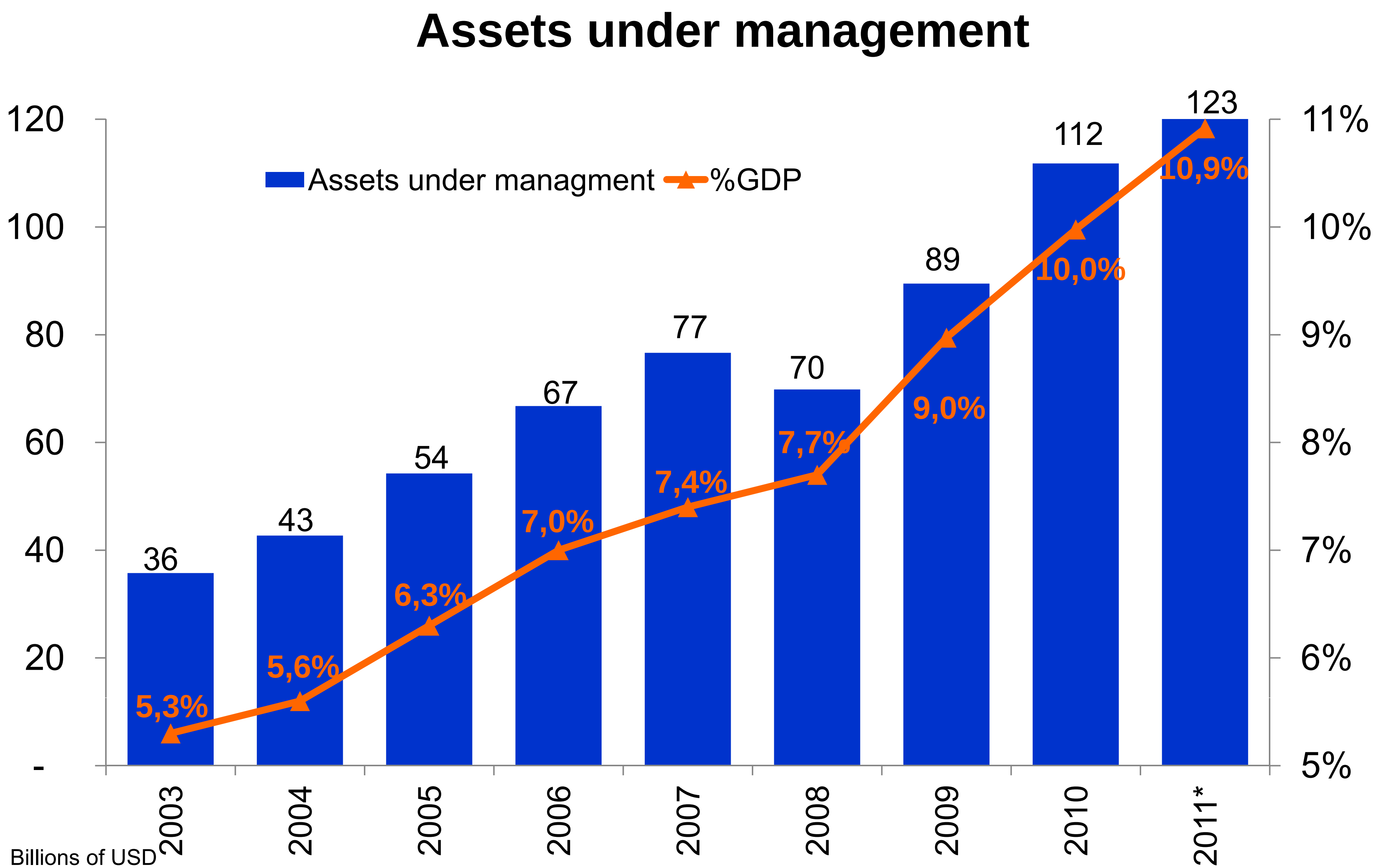
## II. Current situation

### Number of accounts

| | |
|---|---|
| **Total** | **42.0** |
| Contributing * | 21.5 |
| Non-contributing | 19.5 |

* With at least one contribution in the last 3 years
Source: Consar

# II. Current situation

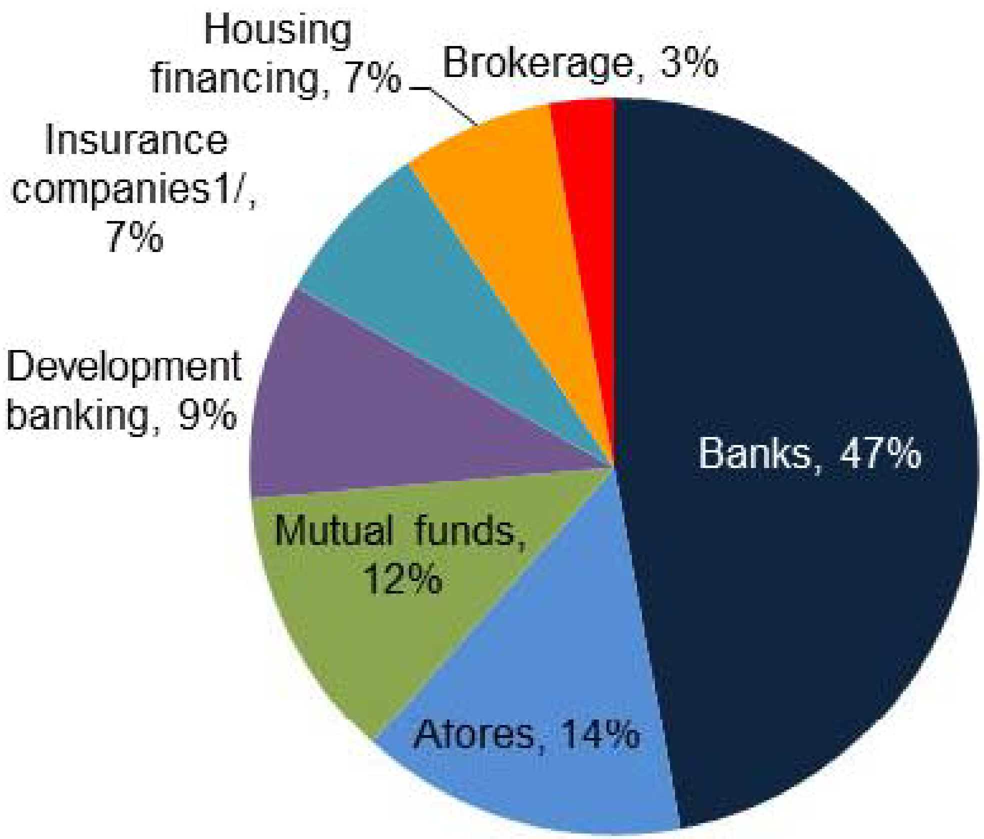



Billions of USD

* August 2011

# II. Current situation

## Structure of the financial sector (AuM)

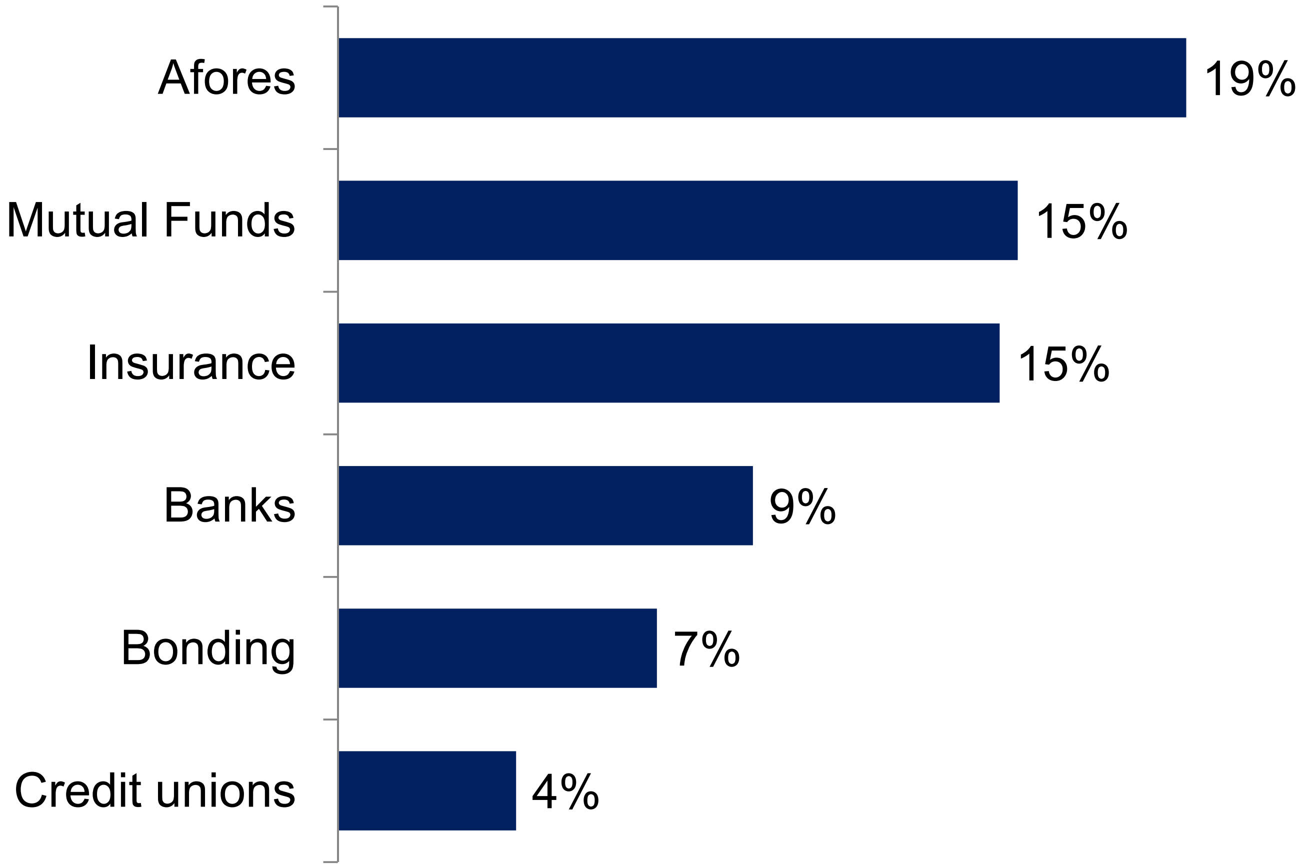



Source: Banxico

[1/] includes annuities companies

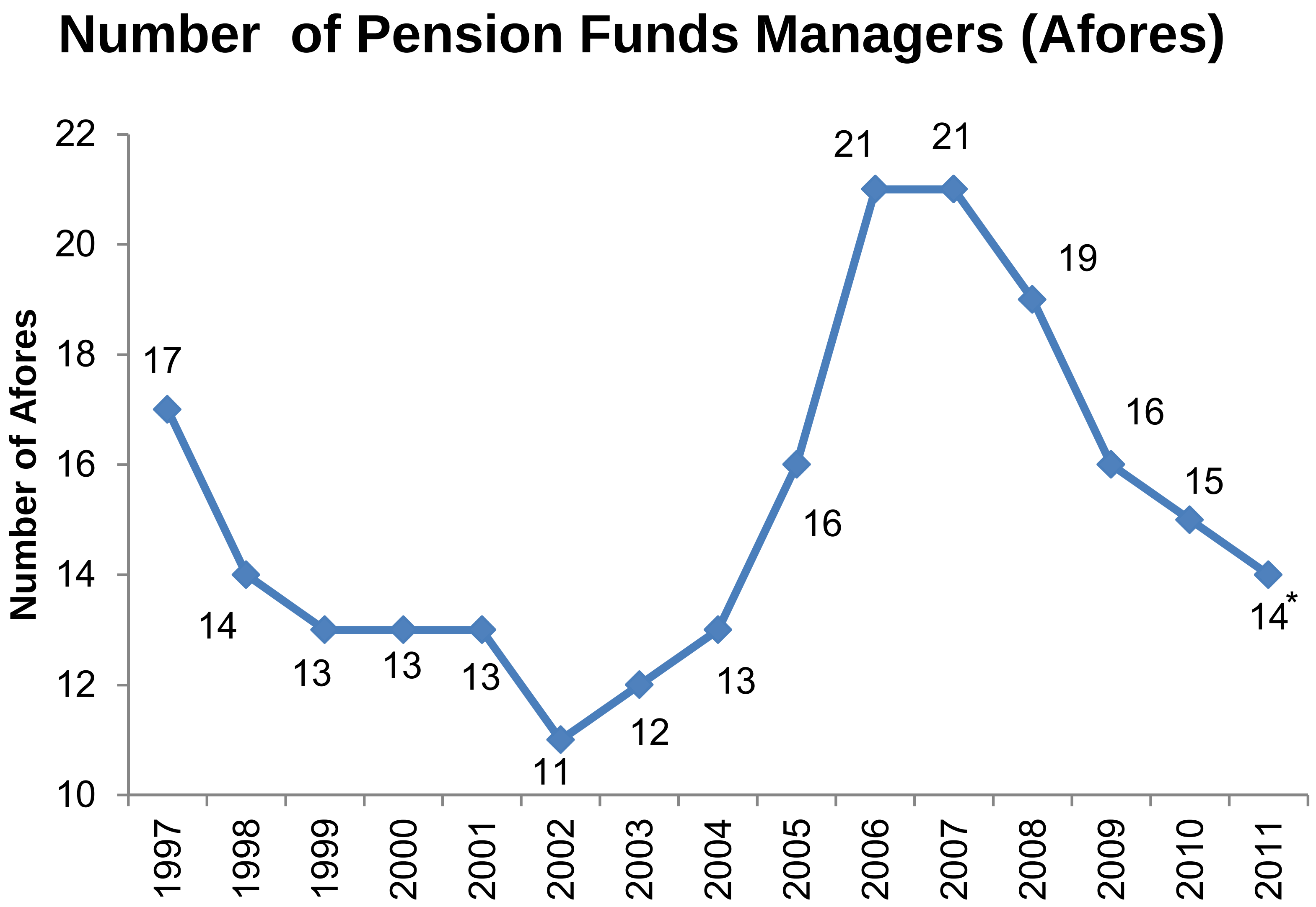
# II. Current situation

## Annual growth rate of total assets 2000 - 2010




Source: Banxico

# II. Current situation




Source: Amafore

* Includes government owned PensionIssste

# II. Current situation

## Competitors and market share

| Firm | Subsidiary of: | % market share |
|---|---|---|
| Banamex | Citigroup | 16.8% |
| Bancomer | BBVA | 15.0% |
| ING | recently acquired by Colombian Grupo Sura | 13.7% |
| Profuturo GNP | Local insurer | 10.7% |
| Inbursa | Local bank | 7.4% |
| XXI | Government (50%) and Prudential (50%) | 6.8% |
| Principal * | Principal Group | 6.8% |
| Banorte Generali | Local bank+Generali | 6.2% |
| PensionISSSTE | Government agency | 6.2% |
| Invercap | Local fund manager | 3.7% |
| Coppel | Local retailer | 2.8% |
| Metlife | Metlife | 2.5% |
| Azteca | Local retailer | 0.8% |
| Afirme-Bajío | Local banks | 0.5% |
| Total | | **100%** |

# II. Current situation

## Evolution of regulatory framework

| | 1997-2001 | 2001-2003 | 2004-2007 | 2008-2011 |
|---|---|---|---|---|
| Number of funds per Manager (Afore) | 1 | 1 | 2 | 5 life cycle funds |
| Metric of market risk | 65% of assets under 65 days maturity | Maximum average maturity = 900 days; then VaR= 0.60% | VaR= 0.60% SB1 and 1% SB2 | VaR= ranging from 0.70% to 2.1% |
| Assets classes | Local debt<br>(public & private) | Local debt<br>▪States and municipalities<br>▪ Government agencies (CFE and PEMEX) | Local debt<br>▪States /municipalities; Government agencies (CFE and PEMEX)<br>▪Foreign debt<br>▪Securitization<br>▪Equity (indexes)<br>▪Derivatives | Local debt<br>▪States/municipalities CFE&PEMEX<br>▪Foreign debt<br>▪Securitization<br>▪Equity (stock picking)<br>▪Financial derivatives<br>▪REITs<br>▪Private equity<br>▪ Commodities<br>▪ Seg. Mandates |
| Foreign securities limit | Excluded | 20% | 20% | 20% |

# II. Current situation

## Investment regime: main criteria

| | | | Limits by type of fund [a/] | | | | |
|---|---|---|---|---|---|---|---|
| | | | SB1 | SB2 | SB3 | SB4 | SB5 |
| Market risk | | VaR (historical, 95%, 1 day) | 0.7% | 1.1% | 1.4% | 2.1% | 2.1% |
| | | Equity | 5% | 25% | 30% | 40% | 40% |
| | | Commodities | 0% | 5% | 10% | 10% | 10% |
| | | Currency | 30% | 30% | 30% | 30% | 30% |
| | | Financial derivatives | Yes | Yes | Yes | Yes | Yes |
| Counterparty Risk | Local | Corporate securities and financial derivatives (counterparty rated mxAAA [1)] | 5% | 5% | 5% | 5% | 5% |
| | | Corporate securities and financial derivatives (counterparty rated mxAA [1)] | 3% | 3% | 3% | 3% | 3% |
| | | Corporate securities and financial derivatives (counterparty rated mxA [1/)] | 2% | 2% | 2% | 2% | 2% |
| | | Corporate securities issued in foreign currency (counterparty rated BBB+ [2)] | 5% | 5% | 5% | 5% | 5% |
| | | Corporate securities issued in foreign currency (counterparty rated BBB- [2/)] | 3% | 3% | 3% | 3% | 3% |
| | Foreign | Foreign securities (counterparty rated A- [2)] | 5% | 5% | 5% | 5% | 5% |
| | | Limit upon each issue | Max (35% of issuing or 25 USD millions) | | | | |
| Other assets | | Foreign assets | 20% | 20% | 20% | 20% | 20% |
| | | Securitizations | 10% | 15% | 20% | 30% | 40% |
| | | Private equity (CKDs, small cap IPOs, REITs) | 0% | 10% | 15% | 15% | 15% |
| | | Inflation protected securities | Yes (51%min) | No | No | No | No |
| Conflicts of interest | | Securities issued by related entities | 15% | 15% | 15% | 15% | 15% |
| | | Securities issued by parties related to Afore | 5% | 5% | 5% | 5% | 5% |

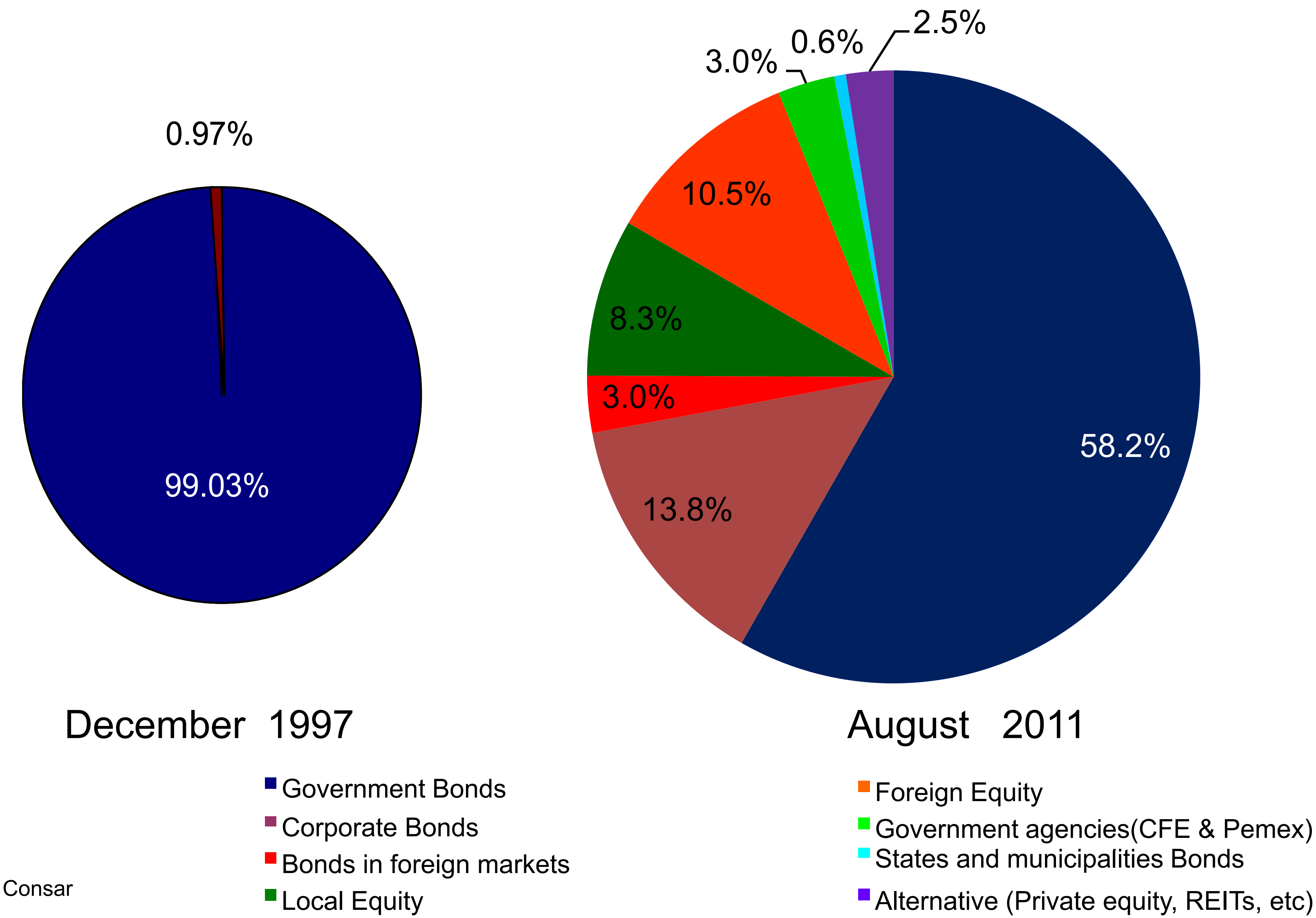
[a/] All limits are maximum percentajes of total assets under managment (w ith the exception of inflation protected securities, w hich is a minimum percentaje)

[1/] Ratings in local scale; securities must be rated at least by tw o agencies

[2/] Ratings in global scale; securities must be rated at least by tw o agencies

# II. Current situation

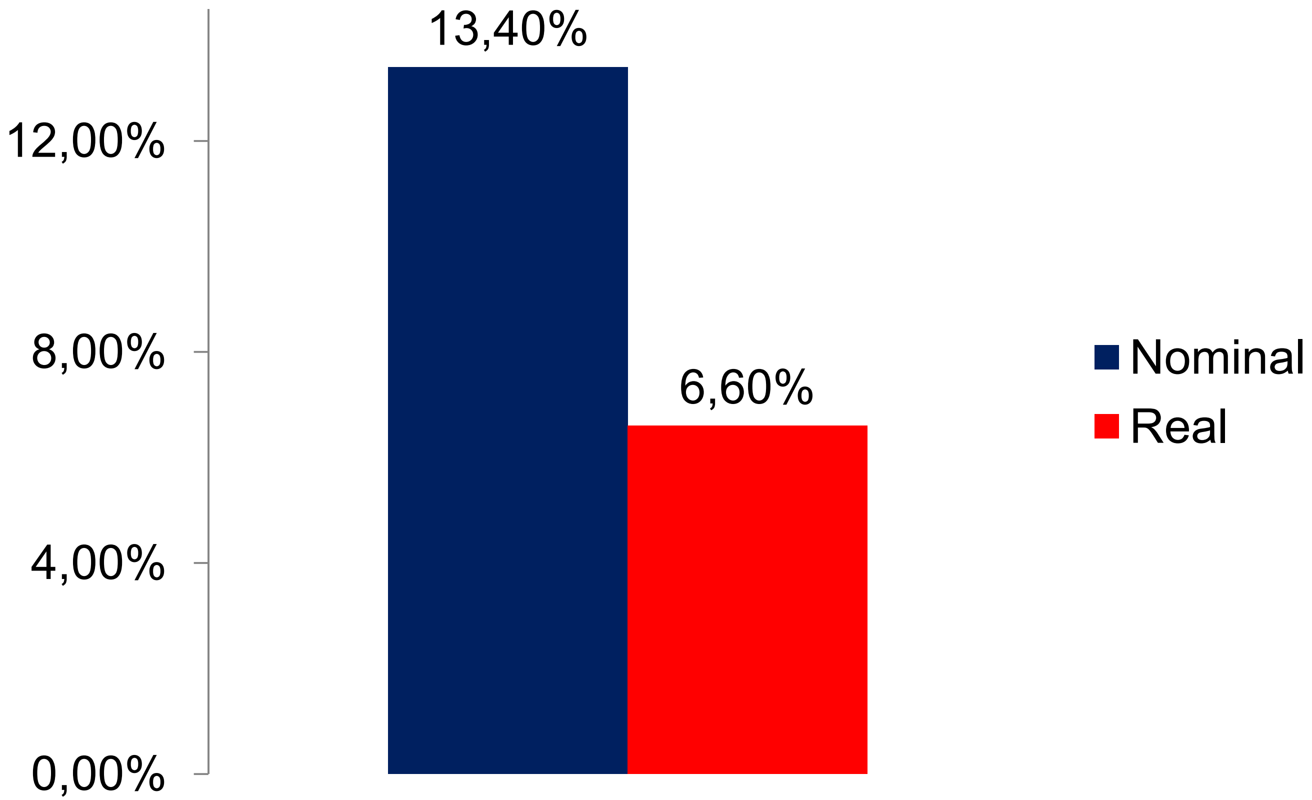
## Average structure of investment portfolios




Source: Consar

# II. Current situation

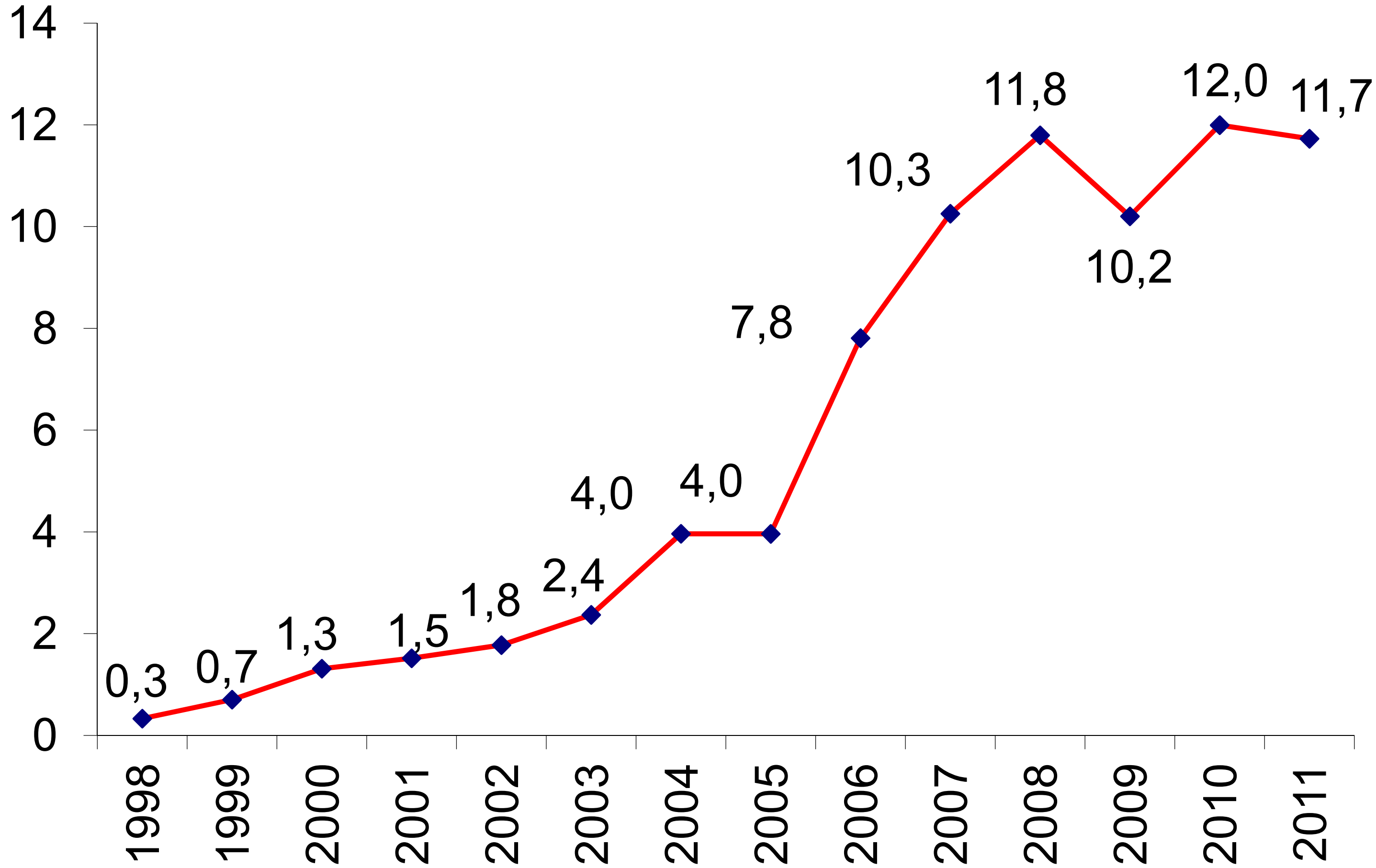
## Historical nominal and real annual average returns (1997 – 2011)




Source: Consar

# II. Current situation

## Portfolio average maturity (years)




Source: Consar

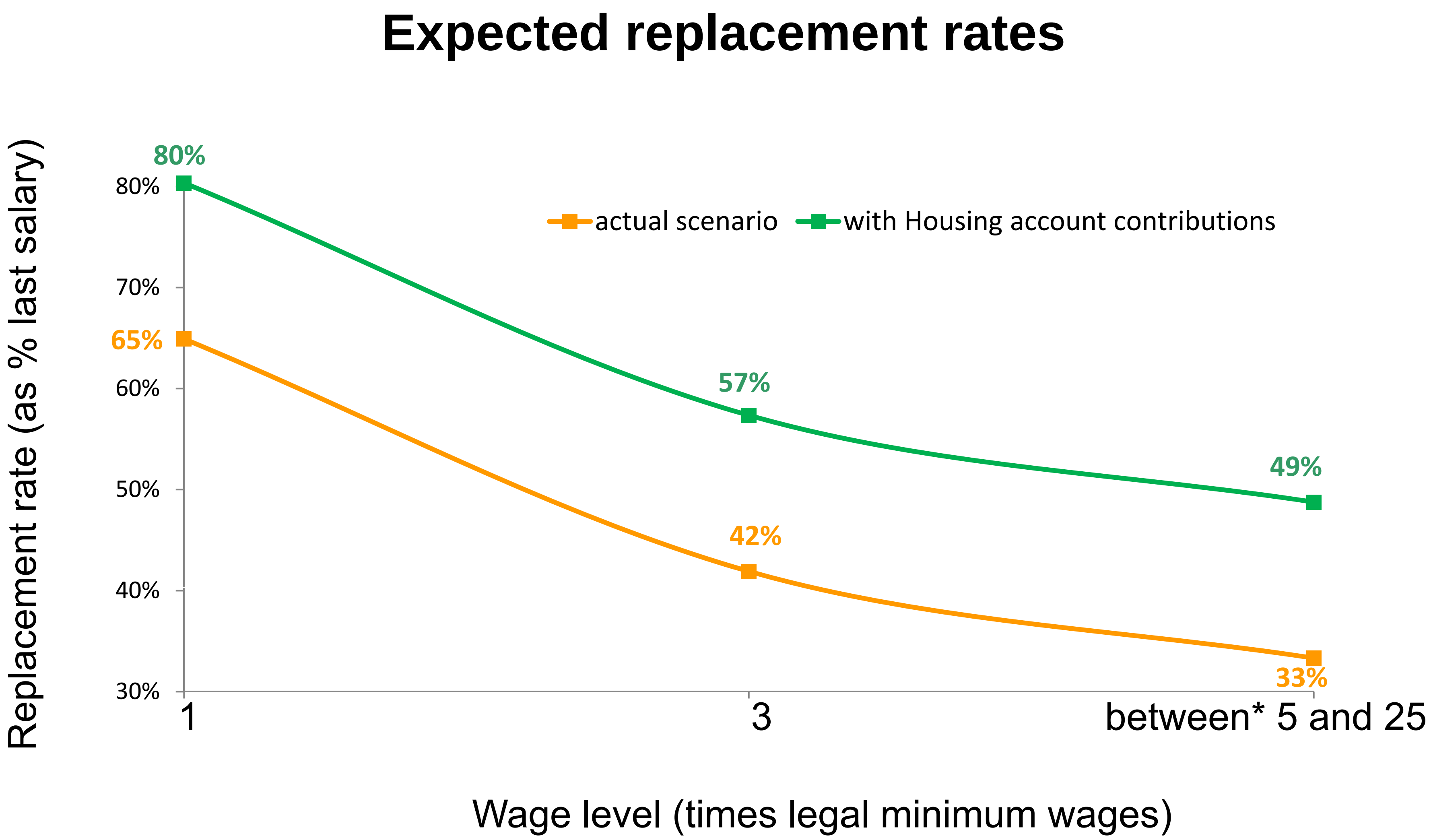
# III. Main challenges

## Retirement contribution rate in Mexico

| Country | Type of System | Total contribution (% of wage) | Contribution to IAS (% of wage) | Contribution to DB (% of wage) |
|---|---|---|---|---|
| Hungary | IAS+DB | **33.50%** | 8.00% | 25.50% |
| Rumania | IAS+DB | **31.30%** | 2.00% | 29.30% |
| Uruguay | IAS+DB | **21.56%** | 14.06% | 7.50% |
| Poland | IAS+DB | **19.52%** | 7.30% | 12.22% |
| Bulgaria | IAS+DB | **18.00%** | 5.00% | 13.00% |
| Colombia | IAS | **13.08%** | 13.08% | |
| Perú | IAS | **11.95%** | 11.95% | |
| El Salvador | IAS | **11.80%** | 11.80% | |
| Costa Rica | IAS+DB | **11.75%** | 4.25% | 7.50% |
| Chile | IAS | **11.64%** | 11.64% | |
| México ISSSTE | IAS | **11.30%** | 11.30% | |
| United Kingdom (CNI) | DB | **11.00%** | | 11.00% |
| United States (OASI) | DB | **10.60%** | | 10.60% |
| Bolivia | IAS | **10.50%** | 10.50% | |
| Dominican Republic | IAS | **8.50%** | 8.50% | |
| México IMSS | IAS | **6.50%** | 6.50% | |

IAS: individual accounts system
DB: defined benefit
OASI: Old age and survivors insurance
CNI:Class 1 National Insurance
Source: International Federation of Pension Administrators (FIAP)

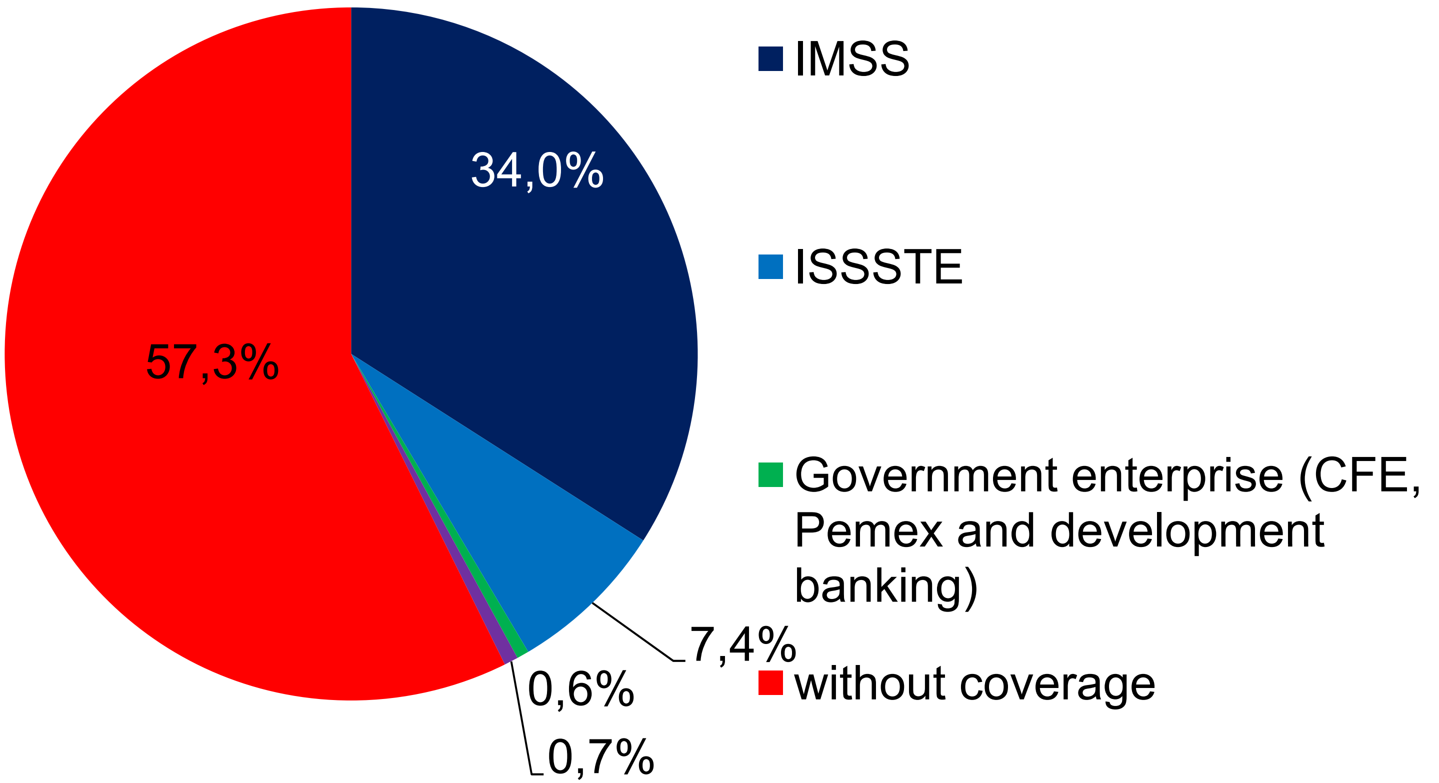
# III. Main challenges




*average replacement rate
Source: Amafore

# III. Main challenges

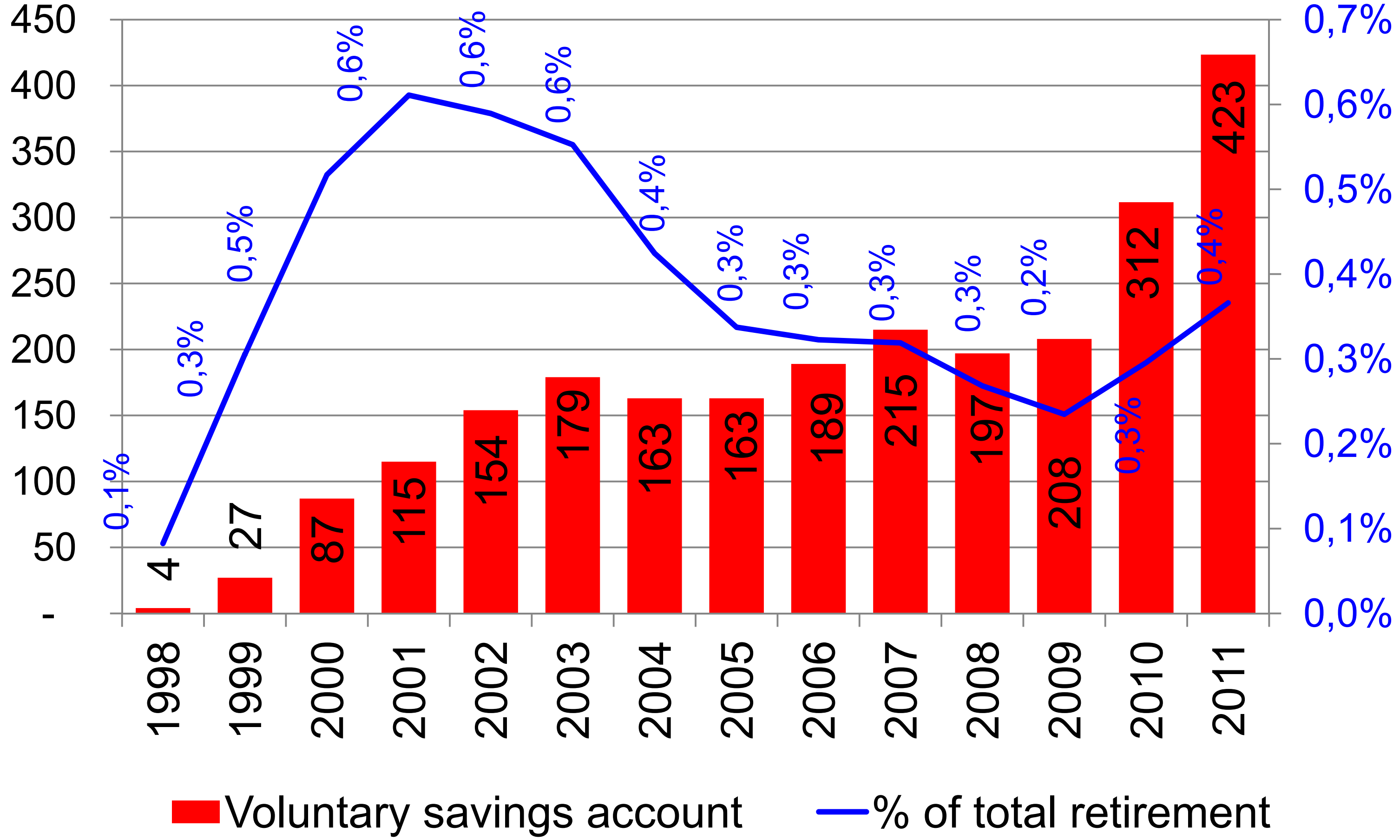
## Retirement benefits coverage, by agency ( % of occupied population)




Source: INEGI

## III. Main challenges

### Voluntary savings as a proportion of total retirement savings




USD millions

Source: Consar

## III. Main challenges

- Address

  - ✓ financial literacy
  - ✓ customer commitment and involvement
  - ✓ property rights
  - ✓ voluntary contributions

- Strengthen

  - ✓ advisory capabilities of providers, especially regarding a clear understanding of the risk/return relationship
  - ✓ its impact on the quality of pensions, and
  - ✓ the danger of overreacting to short-run volatility episodes

## III. Main challenges

- Further evolution of regulation towards diversification

- Enhancement of other relevant regulations regarding taxation, claiming rights of investors, transparency and legal certainty, aimed at triggering long-term investment opportunities

- Alignment of investment strategies with the long-term objectives of private pension funds

- Refinement of life-cycle models and coherent links between the investment strategies of the accumulation and decummulation stages amafore

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