

Economic Watch

Pensions

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Economic Analysis

Pensions

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Relaxation of the investment regime and operating rules in the Retirement Savings System (SAR)

- **Regulatory changes in the Retirement Savings System (SAR) aimed at providing greater flexibility to the investment regime and operating rules of the Retirement Fund Administrators (Afores)**

In the first quarter of 2012, the Comisión Nacional del Sistema de Ahorro para el Retiro (CONSAR - National Retirement Savings System Commission) made regulatory changes that will enable greater dynamism in the market.

- **The investment limit for Structured Instruments (IE) was increased, particularly in the Housing and Infrastructure sectors**

The Sociedades de Inversión Especializadas en Fondos para el Retiro (Siefors - Specialist Pension Fund Investment Companies) can diversify even more their investments, which will enable better returns to be earned for workers.

- **The operating rules as regards advertising and number of promoting agents have been relaxed**

The Afores and Siefors will have greater freedom to advertise their products and decide their workforce size.

- **Through “SAR On-line”, workers can complete procedures in their individual accounts over the Internet, without having to go to their Afore**

Some procedures, such as location and registration of individual accounts, transfers from Afore and joining the mutual savings program for workers paying contributions to the Instituto de Seguridad y Servicios Sociales para los Trabajadores del Estado (ISSSTE - Institute of Social Security and Services for State Employees), can now be completed through the CONSAR website.

- **After nearly 15 years since the SAR was established, regulation has evolved towards greater openness, in line with international standards**

Recent changes will bring more competition to the market, and at the same time represent a challenge for the Afores, which should not excessively increase their advertising and sales expenses and maintain the fee reduction trend seen in recent years.

Changes to the investment regime of the Siefores

After nearly 15 years since the SAR was established, the investment regime of the Siefores¹ has gradually become more flexible, enabling greater portfolio diversification. At the close of April 2012, funds under management by the Afores totaled 1,680,920 million pesos (11.8% of GDP). The accumulated funds are managed in portfolios according to a diversification criterion, depending on the age group of members: of total funds, 58.02% is invested in government securities, 17.13% in domestic private debt, 11.27% in international equity, 7.87% in the local stock market, 2.72% in international debt and 2.99% in structured instruments.

Investment in Structured Instruments

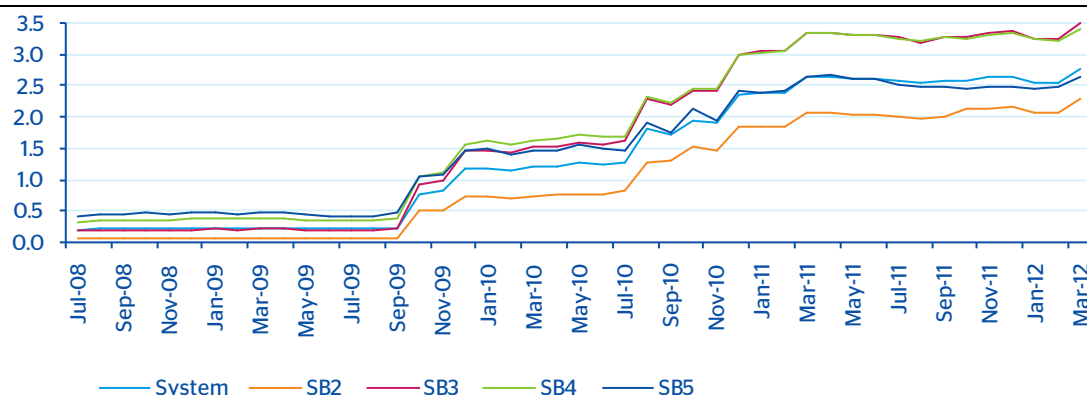
Since 2007, the Siefores have been allowed to invest directly in infrastructure through Structured Instruments (IE), which currently include Capital Development Certificates (CKDs)² and Infrastructure and Real Estate Investment Trusts (FIBRAS)³.

Pension fund investment in this type of assets encourages portfolio diversification and earns potentially attractive returns, since infrastructure assets show low correlation with the returns obtained with other instruments, such as shares and bonds. In addition, they provide a long-term investment horizon -in line with the nature of pension savings-, protection against inflation and constant flows⁴.

The Siefores have gradually increased their investments in this type of assets over time, as seen in the chart below.

Chart 1

Siefores investment in Structured Instruments



Source: BBVA Research with CONSAR data

In the first quarter of 2012, the total investment limit for IE was raised and specific sublimits were established for those instruments that invest in the domestic Infrastructure or Housing sectors.⁵

1: Individual accounts are managed by dedicated administrators (Afores) with monies invested in legally and independent dedicated pension funds (Siefores).

2: They provide direct financing to new companies, specific projects, sectors or industries in México

3: The FIBRAS are an investment vehicle designed for the construction and acquisition of real estate in Mexico for lease and potential sale in the future.

4: See BBVA Research (2010) "Balance y Proyecciones de la Experiencia en Infraestructura de los Fondos de Pensiones en los Fondos de Pensiones en Latinoamérica".

5: Before there was only one limit for IE in general, irrespective of the sector in which they invested.

Table 1

Increase in Structured Instruments investment limits (includes CKDs and FIBRAS)

Previous limit	SB1	SB2	SB3	SB4	SB5
Structured Instruments	0%	10%	15%	15%	15%
New limit	SB1	SB2	SB3	SB4	SB5
Structured Instruments	0%	15%	20%	20%	20%
Infrastructure or Housing	0%	10%	13%	13%	13%
Other IE	0%	5%	7%	7%	7%

Limits as a percentage of total assets managed by the Siefors.
Source: BBVA Research with CONSAR data

Investment in Debt Instruments

The investment regime for the Siefors establishes certain limits for investment in debt instruments in order to control the issuer concentration risk. Before, there were various limits, depending on the credit rating of issuers. However, since March 2012, regulation authorized those limits for common debt instruments issued by the same issuer⁶ irrespective of its credit rating (as long as it is permitted by the investment regime).

Table 2

**Changes to the limits on investment in debt instruments
issued or guaranteed by the same issuer (domestic issuers or counterparties)**

Instrument	Previous limit ^{1/2}
mxAAA domestic currency or BBB+ currencies	5%
mxAA domestic currency or BBB- currencies	3%
mxA domestic currency	2%
mxBBB domestic currency or BB currencies	1%
Instrument	New limit ²
Common debt from mxBBB to mxAAA or currencies from BB to AAA	5%
Subordinated debt from mxBB+ to mxBB- or currencies from B+ to BB-	1%

^{1/} Includes preferred, common and subordinated debt

^{2/} As a percentage of total assets managed by the Siefors. This limit is the same for all the Siefors.

Source: BBVA Research with CONSAR data

Relaxation of operating rules for the Afores

The **advertising** rules for the Afores and Siefors were relaxed in April 2012. It is important to point out that previous regulations established very strict criteria in this area, since it only allowed the Afores (not the Siefors) to carry out certain types of advertising for comparison purposes, and as regards returns they could only use the Net Return Indicator (IRN) published by CONSAR. The recent changes will enable the Afores and Siefors to:

1. Sponsor⁷ activities or events for advertising purposes.
2. Distribute promotional articles which do not place conditions on the registration or transfer of individual accounts.
3. Send information on the SAR through their shareholders or the financial group they belong to.
4. Provide expanded information on the⁸ products and services used in comparative advertising.
5. Freely advertise voluntary savings⁹.

6: Domestic issuers or counterparties

7: Subject to the principles of clarity and veracity and based on verifiable technical elements

8: For comparative advertising purposes, the information on fees, returns and Net Return Indicator must be the latest information published by CONSAR, and the Afores may therefore also use information on returns for different terms. Before, only the Net Return Indicator could be used for such purposes.

9: They can compare voluntary savings with similar financial products that can be considered as investment alternatives.

Another major change made to the operating rules is that the Afores can now have as many **promoting agents** as they wish. Before, the workforce size of each Afore depended on the skills and on the administrators' degree of control over their promoting agents¹⁰.

Procedures over the Internet (SAR On-line)

One of the main challenges facing the SAR has no doubt been to make the workers aware of the importance of pension savings, encouraging them to participate actively in the decisions that will affect their post-retirement income. As of April 2012, the Afores managed 46.8 million individual accounts, of which 66% were workers who had voluntarily chosen an Afore (registered workers), while the remaining 34% (16 million accounts) were workers who did not choose an Afore, and whose individual accounts have therefore been assigned to an administrator, in accordance with the rules established by CONSAR¹¹.

A worker who has been assigned to an Afore may at any time voluntarily decide to remain with that administrator (register) or switch to another Afore. It should be noted that the administrators do not have available full information on registered workers and, therefore, cannot send account statements to their homes, thus preventing this type of workers from having control over their retirement savings. It is therefore particularly important for these workers to know which Afore is managing their individual account and register it.

In order to simplify this procedure and others involving the individual accounts of the workers, "SAR On-line" was implemented. This mechanism will enable some procedures to be completed over the Internet from the CONSAR website without having to go to a branch office of the Afore. The following procedures can be completed on-line:

- Account location (find out which Afore the worker is assigned to)
- Worker registration with the Afore (if the worker has been assigned to an administrator and wishes to remain with it)
- Transfers between Afores¹² (checking the worker's identity via e-mail and credit or debit card).
- Adding and changing contributions to the mutual savings program¹³ of ISSSTE (only for state workers).

Assessment

In general, the recent regulatory changes made to the SAR can be considered positive, as they provide greater relaxation in both the investment regime of the Siefiores and in the operating rules governing transfers, promoting agents and procedures that may be completed over the Internet.

The changes in the investment regime of the Siefiores could drive investment in structured instruments, mainly in the domestic housing and infrastructure sectors. At the same time, they involve challenges for the Siefiores in terms of strengthening their credit risk analysis areas, since due to the authorization of investment limits for issuers with different credit ratings, more funds may be invested in debt issued by small and medium-sized companies. On the other hand, by having more funds

10: According to those criteria, CONSAR granted a rating to each Afore that determined whether it could increase the size of its workforce, as well as the percentage of increase.

11: The funds of these workers are administered by the Bank of Mexico, while the registration and supervision of their individual accounts is handled by a Service Provider Afore. Once a year, individual accounts showing consecutive contributions during the previous six two-month periods are assigned to the Afores with the highest IRN scores.

12: For individual accounts with balances greater than 7,000 minimum wages (\$436,000), the switch to another Afore must necessarily be made over the Internet, while for accounts with balances below that limit the transfer can also be made through promoting agents or directly at the Afore's branch office.

13: Ahorro Solidario (Joint Savings) is a voluntary scheme for ISSSTE (the public-sector workers' social security system) contributors that is supported by the Federal Government and in which the agency contributes 3.25 pesos for each peso contributed by the worker (maximum contribution by the worker up to 2% of the base contribution salary). Before, workers could only join this scheme or change their contribution to it in November and December of each year, whereas now they can complete those procedures at any time over the Internet.

invested in IE -instruments with low liquidity- the Siefors must have policies in place for properly managing liquidity.

The flexibility of the SAR operating rules for advertising and promotion is very important for the workers, since it could boost the individual account's interest and sense of belonging, and raise awareness among the population of the importance of voluntary savings for increasing their pension, while the implementation of "SAR On-line" should make it easier for workers to complete certain procedures over the Internet without having to go to a branch office of the Afore or contact a promoting agent.

It is important to point out that more than one third of the SAR accounts are not registered with an Afore. This is relevant, since workers who have not registered cannot receive their account statement or complete certain procedures such as applying for mortgages, withdrawing unemployment or marriage funds, or starting their retirement procedure. Thus, with the implementation of "SAR On-line", the account location and registration procedure should be easier.

Although the combined effect of greater flexibility in the operating rules for advertising and promoting agents may give rise to greater competition in the market, the Afores should try not to increase their advertising and sales expenses excessively, in order to continue with the reduction in the fees they charge.

Also, the Afores and Siefors may include more information in their comparative advertising (using the latest official data published by CONSAR), whereas previously only the administrators (and not the funds) could engage in this type of advertising based on the IRN. This could benefit financially literate workers, but could be confusing for poorly informed workers. The foregoing, together with the flexibility to make Afore transfers over the Internet, could result in transfers being made to administrators that do not necessarily offer higher returns in the long run¹⁴.

Thus, and given that based on the available information workers must make decisions that will affect the amount of their pension, it is particularly important to intensify financial literacy campaigns for the population so that workers understand the importance of voluntary savings, the fees and the long-term returns, in order to obtain a higher income after retirement.

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¹⁴. The regulations allow transfers to be made freely between Afores once a year. Only transfers made before one year must follow the rules defined by CONSAR, which only allow workers to switch to administrators that have consistently offered good returns.

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