

A Scorecard Of Privatization Of Publicly Mandated Pensions In Mexico

BY TAPEN SINHA

A new publicly mandated and compulsory but privately operated pension system came into existence in Mexico on 1 July 1997. All workers (in the formal sector of the economy) are covered by the new system. The private pension plans in the new system are called *Administradores de Fondos de Retiros* or AFOREs. At present, there are 17 authorized AFOREs. Some AFOREs are totally Mexican-owned, such as Inbursa. Others, like Bancomer, have substantial foreign holdings. Given the North American Free Trade Agreement (NAFTA), most foreign participation is through US or Canadian companies.

Some of the companies have taken an early lead in their market share. The two largest ones are affiliated with the two largest banks in Mexico, Bancomer and Banamex. The curious fact is that Siglo XXI (the privatized reincarnation of the "old" social security system) is not among the top five in the AFOREs market. The regulatory body has explicitly put an upper limit of 20% of all accounts on the market share that any single AFORE can have. It is curious that there is no limit in terms of *value* of the market share.

As of 15 March, 79.6% of workers were affiliated with AFOREs. The estimated number of workers at that date was 14,819,093.

BASIC FEATURES

The existing system that AFOREs will replace is a pay-as-you-go scheme run by the government. Management of the old system rests with the Instituto Mexicano del Seguro Social (IMSS). The IMSS estimates that by 1999, the 8.5% payroll tax financing the benefits will fall short of the pensions paid out.

The IMSS also runs a disability and life insurance plan. It is important to note that AFOREs will replace only the old age retirement benefit part of the IMSS, while the IMSS will continue to run the rest. It is also important to note that existing members of

the old scheme may continue their membership in the old scheme if they choose to. Therefore, the new system is important only to workers who enter the workforce on or after 1 July 1997.

The new system is a fully funded (defined contribution) plan. Hence, any change in the population structure will not affect the benefits.

The new system is expected to increase the national savings rate. It is not very clear whether that will indeed be the case. Clearly it will increase involuntary savings. However, if voluntary savings in the economy falls one for one, then it is hard to see why there will be an overall increase in national savings. However, evidence from other countries—Chile and Singapore, for example—seem to show that such a scheme does increase total savings.

It also will bring more long-term capital into the market. There is no doubt about this aspect of the new system. By definition, retirement plans are long-term investments.

Most people will have most of their investment locked in for many years until they retire. Mexico has traditionally lacked long-term capital. For example, the most active



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Table 1: AFOREs Authorized By The CONSAR

AFORE	Main Shareholders	Percentage Holding[†]
ATLANTICO PROMEX	Banca Promex Banco del Atlantico	50% 50
BANAMEX	Grupo Financiero Banamex-Accival	100
BANCOMER	Grupo Financiero Bancomer Aetna Internacional, Inc.	51 49
BANCRECER-DRESDNER	Grupo Financiero Bancrecer Dresdner Pension Fund Holdings Allianz Mexico, S.A.	51 44 5
BITAL	Grupo Financiero BITAL ING America Insurance Holding, Inc.	51 49
CAPITALIZA	General Electric Capital Assurance Co.	100
CONFIA-PRINCIPAL	Abaco Grupo Financiero Principal International	51 49
GARANTE	Grupo Financiero Serfin Grupo Financiero Citibank Hábitat Desarrollo Internacional	51 40 9
GÉNESIS	Seguros Génesis, S. A.	100
INBURSA	Grupo Financiero INBURSA	100
PREVINTER	Boston AIG Company The Bank of Nova Scotia	90 10
PROFUTURO GNP	Grupo Nacional Provincial Banco Bilbao Vizcaya-México, S. A. Provida Internacional, S. A.	51 25 24
SANTANDER MEXICANO	Grupo Financiero Invermexico Santander Investment, S. A.	75 25
SIGLO XXI	Instituto Mexicano del Seguro Social IXE Grupo Financiero	50 50
SÓLIDA BANORTE	Grupo Financiero Banorte	100
TEPEYAC	Seguros Tepeyac	100
ZURICH	Zurich Vida, Compañía de Seguros Gabriel Monterrubio Guasque	77 10

[†]No mention is made of shareholders with equity participation under 5% of the total capital of the respective AFORE.

Source: CONSAR

form of investment in the market now is that of 28-day CETES (short-term government bonds). Bonds of a duration of more than five years are very rare. The new AFOREs market will lead to considerable securitization. This process will bring depth to the market and eventually will result in greater capitalization. At present, AFOREs legally cannot invest in any assets other than the CETES. But eventually, like in the case of Chile, investment in other types of assets—including investment in blue-chip stocks—will be allowed. Thus, market capitalization of the Mexican stock market will rise.

PROBLEMS WITH THE SYSTEM

The system is not without its cost. At present, there are 70,000 new recruits in the AFOREs whose sole job is to get more people

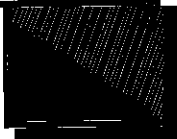
to sign up for the AFOREs. For the past year, the media in Mexico has been saturated with advertisements about AFOREs; the blitz is still continuing. Of course, all of this comes at a price which members of the system will have to pay for in the form of higher transaction costs.

The only other country that has run a similar system for more than a decade is Chile. Initial cost of running an AFP account (the Chilean equivalent of the AFORE) has been 15% or more (of deposits). Take an example from Mexico. One of the largest AFOREs is that of Bancomer. For every 100 peso deposit, Bancomer charges 26 pesos. Many other AFOREs have charges of a similar magnitude. Given that each person can switch an AFORE once a year without any penalty, it is likely that many people will switch; the experience in Chile tells us so.

Table 2: Market Share

AFORE	Members	Market Share (Percent of Members)
BANCOMER	1,905,993	16.14%
SANTANDER MEXICANO	1,701,697	14.41
PROFUTURO GNP	1,468,592	12.44
BANAMEX	1,402,508	11.88
GARANTE	1,294,550	10.96
BITAL	1,082,592	9.17
SOLIDA BANORTE	935,590	7.92
BANCRECER-DRESDNER	556,547	4.70
SIGLO XXI	327,470	2.77
INBURSA	181,660	2.55
PREVINTER	281,476	2.38
ATLANTICO-PROMEX	181,660	1.53
GÉNESIS	129,485	1.09
TEPEYAC	97,626	0.82
CONFIA-PRINCIPAL	77,104	0.56
CAPITALIZA	36,641	0.19
ZURICH	21,902	0.10

Source: CONSAR



EARLY RESULTS

The performance of the first six months of operation of the AFOREs has just been published. The graph on the left below gives the annualized percentage rate of return of the fund. Given that funds can only invest in CETES, it is not surprising that the rates of return are very similar. However, there are two caveats: (1) the inflation rate has been 15.5%; and (2) the table does not include any transaction fees that people incur.

The real rate of return for the account holders after all the charges are paid have been negative for most AFOREs. In Chile, they were so for the first five years! Thus, the 2% real rate of return on the consolidated account, even after paying expenses of 1.15%, does not

look bad. The right graph drives the point home.

CONSOLIDATION

Recently a shakeup in the industry got under way. In April 1998, Previnter announced a merger with Profuturo. Previnter has a small market share. Thus, we already are witnessing a consolidation in the industry. There is also a good likelihood that Inbursa is going to take over Confia. If it goes through, it will boost the market share for Inbursa. Inbursa currently has 2.55% of total number of workers. However, it is aiming at the high income market. Thus, in terms of total investment, it has a market share of more than 12%. With the addition of Confia, it will consolidate it's position. ■

