

Unsettled start for a valuable

By Tapen Sinha

In only about a year of existence, Mexico's new privatized pension scheme appears to have some shortcomings. It invests only in short-term instruments. Participants pay high fees and so far have received mostly a net negative return.

So how should one judge the new Mexican scheme, adapted from the long-standing Chilean pension plan, which also is held out as a model for privatizing the U.S. Social Security system?

It has been a success. The system has not been without its costs and lingering uncertainties, but these should disappear as it grows and matures.

Besides participants, policy-makers, too, are expecting many wonderful things from the "Great Pension Reform." Will it deliver? Let us critically look at each issue.

STARTING NEW PENSION SYSTEM

The new pension scheme began July 1, 1997. The regulatory body, known as CONSAR, authorized 17 AFORES, or Administradora de Fondos de Retiros, to manage the pension fund investments. AFORES in Mexico are similar to the AFPs in Chile. They are private; most of them are subsidiaries of banks and insurance companies in Mexico; and, so far, they are highly regulated in what kind of market instrument they can invest, confined for now to short-term instruments. Participants select in which AFORE to invest their contributions.

As of April 30, a total of 12,112,151 persons out of a potential pool of 14,819,093 participants enrolled in the new program have selected an AFORE (about 82% in 10 months).

Enrollment in the system is mandatory, although participants don't have to choose an AFORE. Those who don't choose one have their money deposited in a consolidated fund run by Banco de Mexico, the central bank. That fund pays 2% real rate of return and charges a fee of around 1.5%. Eventually, all of the ac-

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counts in this fund will be distributed among AFORES in proportion to their share of the market.

How much money is in the new system? As of April 30, the total investment in the AFORES exceeded \$3 billion. To get an idea how large this is, consider the following information: Frank Russell Co. estimated there was about \$2.7 billion managed in the Mexican market in early 1995 by the institutional money managers of the United States.

How large will the pension fund grow? If it follows the footsteps of Chile, in 25 years, the amount of money invested in the pension system could grow to 40% to 50% of gross domestic product.

THE GREAT PIÑATA OF REFORM

For policy-makers, the new system represents a great piñata of potential benefits to the capital markets as well as participants.

First, the system is supposed to be actuarially solvent. By definition, it will be for all the new entrants because by law, they will not be allowed to enter the old, pay-as-you-go system. The new system is a defined contribution plan. Hence, any change in the population structure will not affect the benefits.

Second, it also is expected to increase the national saving rate. It is not very clear whether that will be the case. Clearly it will increase involuntary saving. But, if voluntary saving in the economy falls one for one, then it is hard to see why there will be an overall increase in national saving. Evidence from other countries (Chile and Singapore) seems to show that such a scheme does increase total saving.

It is instructive to keep in mind the main architects of the Chilean system did not envision an increase in saving. It was not even mentioned in the first document that outlined potential benefits for Chile. In Mexico, things are entirely different. Policy-makers are pinning great hope on increased saving.

For example, the report by the Bank of Mexico titled "The Mexican Economy: 1997" states unequivocally: "The proper functioning of the new pension system will improve the Mexican society's capacity to increase its domestic savings." In Chile, sweeping reforms were undertaken concurrently that made increased saving due to pension reform possible.

Third, it is expected to bring more

Competition for and perform

AFORE	Par
Atlántico-Promex	1.4
Banamex	1.4
Bancomex	1.5
Bancrocer	5
Banorte	5
Bital	1.1
Capitaliza	
Costilla-Principal	
Garantía	1.5
Gómesa	
Inbursa	
Previnter	
Pro futuro GNP	1.1
Santander Mexicano	1.1
Tepeyac	
XXI	
Zurich	
Total participants	12.1
Average return	

AFORES creating are:
1. Atlántico-Promex, Costilla-Pr
2. Gómesa and Santander Mex
3. Previnter and Pro futuro GNP
Source: El Financiero and COF

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LETTERS TO THE EDITOR

AIMR ethics or business?

■ We were surprised by the comments in Ronald J. Surz's commentary (*Pensions & Investments*, July 27) regarding the Association for Investment Management and Research's performance presentation standards. While Mr. Surz says that his company, Roxbury Capital Management, has been notified to be in compliance with

compliance and 45% require compliance when sending out requests for proposals.

We also were surprised to read Mr. Surz's opinion that plan sponsors indicated a lack of interest in the AIMR-PPS standards at the conference he attended. AIMR staff have spoken at a number of well-attended industry conferences on this very topic where not only consultants, but also numerous plan sponsors, have made their interest in and

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Third, it is expected to bring more

Competition for participants and performance

AFORE	Participants	Return (%)
Atlántico-Promer	184,002	21.50
Banamex	1,416,490	21.38
Bancomer	1,942,760	23.12
Bancorcor	580,439	14.55
Banorla	982,633	21.89
Bital	1,108,559	20.86
Capitaliza	43,905	20.66
Conifa-Principal	83,055	19.96
Garante	1,334,916	20.27
Génesis	133,983	20.78
Inbursa	300,612	21.15
Previnter	298,654	20.85
Profuturo GNP	1,499,679	22.27
Santander Mexicano	1,751,067	20.40
Tepeyac	93,836	20.94
XXI	343,727	19.81
Zurich	24,634	20.65
Total participants	12,112,151	
Average return		20.66

AFORES combining are:
 1. Atlántico-Promer, Conifa-Principal and Inbursa.
 2. Garante and Santander Mexicano.
 3. Previnter and Profuturo GNP.
 Sources: El Financiero and CONISAR JOHN HALL

long-term capital into the market. There is no doubt about this aspect of the new system. By definition, retirement plans are long-term investors. Most participants will have most of their investment locked in for many years until they retire. Mexico has traditionally lacked long-term capital in the market. For example, 80% of investment in the capital market now is that of 28-day CETES, the short-term government bonds. Bonds of duration more than five years are very rare indeed. The AFORES market will lead to considerable securitization. This process will bring depth to the market.

Fourth, it eventually will bring more capital to the stock market. Although restricted now by law to only CETES, AFORES eventually, like their counterparts in Chile, will be allowed to invest in other types of assets, including stocks. Thus, the market capitalization of the Mexican stock market will rise.

It is instructive to keep in mind what happened in Chile on this score. By 1995 the limit of investment by AFPs in Chile in the stock market was raised to 37% of the portfolio, but most fund managers invested in fewer than 10 companies. But

1995 saw a stock market downturn in Latin America. Fund managers' investment in the stock market was a complete disaster. The lesson there is simple: Investing in a few (risky) companies is a recipe for disaster in the long run.

PROBLEMS WITH NEW SYSTEM

The system is not without its cost. At present, there are 70,000 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 continuing.

Of course, all of this comes at a cost. Eventually, all of this has to be paid for by the participants in the form of higher management 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 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 similar magnitude.

NEGATIVE NET PERFORMANCE

Performance in the first 10 months of operation of the AFORES has just been published. Given that funds can only be invested in CETES, it is not surprising the rates of return are very similar.

However, there are two caveats: The inflation rate has been 14%, and the performance numbers do not include any management or transaction fees that participants incur. Due to the presence of transaction fees, for most AFORES, the net rate of return is negative. What is even more striking is that it will remain negative for several more years.

OUTLOOK

No formal timetable has been set for allowing the system to invest in other forms of market instruments. But CONISAR might allow equity investments in three to five years (some legal problems need to be worked out before AFORES would be allowed to invest in equity).

The new system, nonetheless, will add depth to the capital markets, bringing in more market instruments, such as inflation-indexed bonds, and more long-term capital instruments, such as 25-year government and corporate bonds. However, transactions costs remain a worry.

LETTERS TO THE EDITOR

Backing AIMR standards

I once saw a movie titled "The Eye of the Beholder," which demonstrated how people could make a variety of interpretations from seeing the same event.

Ronald J. Surz's July 27 commentary is a good example. I moderated the Institute for International Research...

because it provides firms with a level of assurance that they are, in fact, complying. This is based partly on my understanding that the Securities and Exchange Commission might cite a firm with committing fraud if they're found to be out of compliance with the standards.

We strongly encourage compliance, and

compliance and 45% require compliance when sending out requests for proposals.

We also were surprised to read Mr. Surz's opinion that plan sponsors indicated a lack of interest in the AIMR-PPS standards at the conference he attended. AIMR staff have spoken at a number of well-attended industry conferences on this very topic where not only consultants, but also numerous plan