Chapter 2

The Mexican pension system today

This chapter succinctly describes the Mexican pension system. The Mexican pension system is mainly based on funded defined contribution individual accounts introduced in 1997 for private-sector workers and in 2007 for public-sector workers. The public pension component consists of the old pay-as-you-go defined benefit pension system, which still covers workers who entered the labour market before the introduction of funded defined contribution individual accounts, a minimum guaranteed pension and an alternative means-tested non-contributory pension for people older than 65.

2.1. Overview of the Mexican pension system

The Mexican pension system has four components: i) the federal and state non-contributory (first-tier) pension schemes, (ii) the mandatory defined contribution Retirement Savings System (*Sistema de Ahorro para el Retiro*, SAR), (iii) special pension schemes for certain public-sector employees and state universities, and (iv) individual and occupational voluntary pension plans.

The most important nationwide non-contributory scheme in Mexico, called the pension for the elderly (*Pensión para Adultos Mayores*), is funded by the federal budget. The programme started in 2007 and initially provided a pension to everyone aged 70 or over who lived in towns with populations up to 30 000 inhabitants. In 2012, the pension for the elderly was extended to all the country, and was granted to all those people who did not receive an old-age pension from any social security institution above a certain threshold. Starting in 2013, the programme was extended to cover all people aged 65 and over. In addition to the federal scheme, some states also have their own non-contributory scheme.

The main component of the Mexican pension system is the Retirement Savings System (SAR). This is a mandatory defined contribution (DC) fully funded system with individual accounts. All private-sector employees who entered the labour force on or after 1 July 1997 and most public-sector employees who entered the labour force on or after 1 April 2007 have an individual account in the SAR. Mandatory contributions from employees, employers and the government are deposited in these individual accounts which are invested in pension funds known as SIEFORE (*Sociedades de Inversión Especializadas en Fondos para el Retiro*) and managed by specialised private managers known as AFORE (*Administradoras de Fondos para el Retiro*).

The Retirement Savings System was created in 1992 when the revised Social Security Law was passed. This Law included for the first time funded DC individual accounts that were intended to complement the existing pay-as-you-go (PAYG), defined benefit (DB) public pension system. It mandated a 2% contribution from employers. The reform did not however address the financial unsustainability of the system. As a result, in December 1995 the Mexican Congress enacted a new Social Security Law. In April 1996, a second package established the legal and organisational framework (SAR Law).[1] The new SAR Law substituted the old PAYG DB system for a mandatory DC fully funded system with individual accounts for private-sector employees, complemented with a minimum pension guarantee by the government. It started on 1 July 1997, without any change for the affiliates who were pensioned before that date. In addition, workers who had accumulated pension rights before that date were granted the option to choose at retirement which system (the old DB system, under the 1973 Law, or the new DC system, under the 1997 Law) will be used to determine their pension benefits.

In December 2002, public-sector employees were given the right to voluntarily open an individual account in the AFORE of their choice. However, since the reform of the Law of the Institute for Security and Social Services for State Workers (ISSSTE Law) in 2007, all ISSSTE affiliates have been incorporated to a mandatory individual account pension system, with different rules than that for private-sector workers.[2]

Local governments, municipalities, public universities and state-owned companies (e.g. the oil company PEMEX) have their own pension scheme for their employees.

These systems have different features. Some are DB schemes, while others have migrated to DC schemes at least for new employees.

Voluntary contributions to individual accounts are allowed for employees contributing to the SAR, self-employed workers and informal workers. Some companies also offer to their employees access to occupational pension plans. Some of these plans are partially funded and may be defined benefit, defined contribution or hybrid. Finally, insurance companies and financial groups offer personal pension arrangements with various modalities.

2.2. Non-contributory pension for the elderly

The pension for the elderly (*Pensión para Adultos Mayores*) is a means-tested non-contributory safety net programme funded by the federal budget. It covers people aged 65 and older who do not receive an old-age pension or disability benefits higher than MXN 1 092 per month.[3] It provides a financial support of MXN 580 per month as of 2015. Several states have their own old-age safety net programmes, but the pension for the elderly is the most important nationwide safety net programme (see Chapter 3 for more details about safety nets).

2.3. The Retirement Savings System (SAR)

The Retirement Savings System comprises two social security schemes:

- the Mexican Institute of Social Security (*Instituto Mexicano del Seguro Social*, IMSS), which covers private-sector employees; and
- the Institute for Security and Social Services for State Workers (*Instituto de Seguridad y Servicios Sociales de los Trabajadores del Estado*, ISSSTE), which covers public-sector employees.[4]

Formal-sector employees (i.e. those paying social security contributions), except those covered by special regimes (see Chapter 3), must be enrolled to one of the aforementioned institutions (i.e. IMSS or ISSSTE) for old-age contributory pension entitlements. Once enrolled, formal-sector employees are eligible to select any AFORE of their choice. Workers can switch between AFORE once a year, given that they have been members of their current AFORE for at least one year.[5]

Self-employed workers do not have the legal obligation to become affiliates and make contributions into the compulsory pension system. They can nevertheless voluntarily open an individual account in the AFORE of their choice and make non-compulsory contributions since 2005.

The AFORE charge fees that are deducted from the workers' personal accounts. They can only charge fees on assets under management. They cannot charge, for example, workers any fee for switching to a different AFORE.

Additionally, the National Housing Fund Institute for Workers (*Instituto del Fondo Nacional de la Vivienda para los Trabajadores*, INFONAVIT) and the Housing Fund of the Institute for Security and Social Services for State Workers (*Fondo de la Vivienda del Instituto de Seguridad y Servicios Sociales de los Trabajadores del Estado*, FOVISSSTE) provide housing credits, where the accumulated funds left when reaching retirement are used to finance retirement.

Each individual retirement account, whether under the schemes for private and public-sector employees, comprises three sub-accounts:

- The retirement sub-account (*Subcuenta de Retiro, Cesantía en Edad Avanzada, y Vejez*, RCV): In this sub-account, workers, employers and the government make mandatory contributions to cover retirement insurance, severance at old-age and old-age.
- The voluntary savings sub-account: In this sub-account, the worker or employer freely decides to contribute in order to increase the balance in the employee's individual account.
- The housing sub-account: This sub-account comprises mandatory contributions that employers make to the housing fund managed by the relevant housing fund institute (INFONAVIT or FOVISSSTE), on behalf of their workers (5% of the salary). In case the worker obtains a loan from the housing fund institute, the resources in the sub-account will be used to pay the down payment and the following contributions to service the debt. Under the 1973 Law, any remaining balance at retirement is withdrawn as a lump sum; under the 1997 Law, any remaining balance is transferred from INFONAVIT to the AFORE to complement the employee's pension.

2.3.1. Private-sector employees affiliated to the IMSS

Private-sector workers affiliated to the IMSS are required to have an individual retirement account in the AFORE of their choice. They have the possibility to change AFORE under certain situations as regulated by the Mexican pension regulator (CONSAR). If a worker does not choose an AFORE, the SAR Law stipulates that his/her individual account must be assigned, on a temporary basis, to one of the AFORE that have achieved the largest net returns over a predetermined period. These workers are known as "assigned workers" to distinguish them from the rest of the workers affiliated to the IMSS that have made an active choice of an AFORE.

The total employee, employer and government contribution to the retirement sub-account is 6.5% of salary, of which 1.125% is paid by the employee, 5.15% by the employer and 0.225% by the government (Table 2.1). Contributions are based on the employee's basic salary for contributions, up to a ceiling of 25 times the minimum wage. The government supplements the total contribution with a social contribution called the social quota (*cuota social*) to support affiliates and thus increase the final account balance. This social quota is on top of the 0.225% contribution and depends on the salary level. It is provided for each day of contribution and is updated quarterly in line with inflation.

Table 2.1. **Contributions to the retirement sub-account for private-sector workers**
As a % of the basic salary for contributions, except for the social quota

	Employer	Worker	Federal government	Total
Retirement	2%			2%
Severance and old-age	3.15%	1.125%	0.225%	4.5%
Social quota*			Up to MXN 4.78 daily	Up to MXN 4.78 daily

Note: Social quota in force in November and December 2014. No social quota paid for income above 15 times the minimum wage.

The social quota was initially a flat-rate amount. However, since the amendment of the Social Security Law in May 2009, the amount of the social quota slightly decreases with income. In 2014, its amount declined from about 7% of earnings at the minimum wage to about 1.3% at 5 times the minimum wage and 0.4% at the ceiling of 15 times the minimum wage; for wages above this level no subsidy is paid. During the last quarter of 2014, 89.1% of the private-sector workers affiliated to the IMSS with an active account have received the social quota.[6] Table 2.2 provides the social quota in force in November and December 2014.

Table 2.2. **Social quota by wage level, November to December 2014**

Wage	Social quota (pesos per day)	Social quota as a % of the wage (upper limit)	Total contribution (6.5% + social quota)*
Up to 1 minimum wage	4.78130	7.11	13.61
Between 1.01 and 4 times the minimum wage	4.58208	1.70	8.20
Between 4.01 and 7 times the minimum wage	4.38286	0.93	7.43
Between 7.01 and 10 times the minimum wage	4.18364	0.62	7.12
Between 10.01 and 15 times the minimum wage	3.98442	0.39	6.89
Above 15 times the minimum wage	0	0	6.50

Note: * The 6.5% represents the total employee, employer and government contribution to the retirement sub-account.

2.3.2. Public-sector employees affiliated to the ISSSTE

Public-sector workers affiliated to the ISSSTE are required to have an individual retirement account in the AFORE managed by ISSSTE (PensionISSSTE) or any other AFORE of their choice. Individual retirement accounts are funded by contributions from the employee and the employer (state departments and related bodies), plus the social quota paid by the federal government.

The total employee and employer contribution to the retirement sub-account is 11.3% of salary, of which 6.125% is paid by the employee and 5.175% by the employer (state departments and related bodies) (Table 2.3). Contributions are based on the employee's basic salary for contributions, up to a ceiling of 10 times the minimum wage. The government supplements the total contribution with a flat-rate social quota. This amount is equivalent to 5.5% of the general minimum wage in Mexico City on 1 July 1997, updated quarterly in accordance with the National Consumer Price Index. It is paid for each day of contribution for workers earning less than 10 times the minimum wage. During the last quarter of 2014, 99.6% of the public-sector workers affiliated to the ISSSTE with an active account have received the social quota.

Table 2.3. **Contributions to the retirement sub-account for public-sector workers**

As a % of the basic salary for contributions, except for the social quota

	Employer	Worker	Federal government	Total
Retirement	2%	6.125%		8.125%
Severance and old-age	3.175%			3.175%
Social quota*			MXN 3.98442 daily	MXN 3.98442 daily

Note: Social quota in force in November and December 2014. No social quota paid for income equal to 10 times the minimum wage or above.

The new ISSSTE Law provides a portability scheme for the transfer of savings accumulated under the ISSSTE scheme to the new IMSS scheme, and vice versa, when workers switch jobs between the public and private sectors.[7]

2.3.3. Transitional workers

Transitional workers in the private sector are those employees who were working and contributing to the PAYG system in place before 1 July 1997. Although these workers began contributing to their new mandatory individual retirement account after this date, they retained the right to have their pension benefits at retirement calculated using the old DB formula. A lifetime switch option allows transitional generation workers to choose at retirement the higher of the acquired benefits under the old PAYG DB system and the accumulated balances in their individual retirement accounts under the new funded DC system. If they choose to receive benefits according to the old DB rules, some of the assets accumulated in the individual retirement account are transferred to the federal government to pay the DB benefits, while the rest of the assets (potentially accumulated in different accounts, including SAR IMSS 1992, INFONAVIT 1992, the retirement sub-account, INFONAVIT 1997, and voluntary contributions) are paid as a lump sum.[8]

All public-sector workers who were ISSSTE affiliates at the time the ISSSTE Law was approved in 2007 had the right to choose to switch to the new funded DC scheme or to remain in the old PAYG DB plan.[9] The affiliates had a time limit of six months to choose between these two options, starting 1 January 2008.

The ISSSTE affiliates who chose to move to the new DC system (only 14.2%) received a "recognition bond", paid by the federal government, acknowledging their rights for the periods of time in which they made contributions prior to the reform. This recognition bond was credited in the individual account of the affiliates, redeemable only when close to retirement. Those who had no account in an AFORE at the time of the reform were automatically registered with PensionISSSTE for the first three years. That period ended in December 2011. Since then, workers can transfer their individual accounts to any AFORE of their choice or stay in PensionISSSTE. Since that same date, PensionISSSTE is also able to receive the transfers of individual accounts of private-sector workers or self-employed workers.

New rules regarding the minimum retirement age and the contribution rate apply to ISSSTE affiliates who decided to remain in the old DB scheme (85.8%): the minimum retirement age is being increased gradually from 50 to 60 for men and from 48 to 58 for women by 2028; the contribution rate of workers for retirement increased gradually from 3.5% to 6.125% of the wage contribution base over the six years following the reform. In addition, contributions are directly paid to the ISSSTE to finance the PAYG system, except the 2% employer contribution for retirement insurance, which is deposited in an individual retirement account managed exclusively by PensionISSSTE.

2.3.4. Asset management

Specialised private asset managers (*Administradoras de Fondos para el Retiro*) known as AFORE manage the workers' individual retirement accounts where the IMSS and the ISSSTE deposit the contributions after collecting them. The AFORE place contributions in investment funds called SIEFORE. Thus, AFORE manage individual retirement accounts, while SIEFORE invest the assets generated in those accounts. Workers can choose their AFORE and are free to switch between them once a year.

Currently, AFORE must have four basic SIEFORE for investing the compulsory savings, and they may have additional SIEFORE for voluntary contributions and occupational pension plans. Each basic SIEFORE has a specific investment regime that depends on the age of the worker. This multi-fund system composes a life-cycle scheme. As members are getting older, their pension assets are invested in a more conservative investment regime (with lower exposure to equity and a greater proportion of fixed-income instruments) to reduce the volatility of their returns. Thus, a young worker will gradually move from basic SIEFORE 4 (SB4 up to 36 years old) to SB3 (from 37 to 45 years old), SB2 (from 46 to 59 years old) and finally SB1 (60 years and older). Nonetheless, any worker may opt to invest his/her resources in a more conservative fund than the default option.

2.3.5. Retirement benefits

There are different requirements for public and private-sector workers to be eligible for an old-age pension under the Retirement Savings System. Private-sector workers affiliated to the IMSS need to have contributed 1 250 weeks (24 years plus 2 weeks) and to have reached 65 years of age. Public-sector workers affiliated to the ISSSTE need to have contributed 25 years and to have reached 65 years of age. When the worker does not meet the previous requirements for obtaining an old-age pension, the IMSS or the ISSSTE gives a negative statement to the worker (*negativa de pensión*). In this case, the member can withdraw the total accumulated balance in the individual account all at once at age 65.

When a worker fulfils the age and contribution weeks requirements, retirement benefits are determined based on the accumulated balances in individual retirement accounts managed by the AFORE, plus any remaining balance in the housing sub-account managed by INFONAVIT or FOVISSSTE.

There is a minimum lifetime annuity payment to all workers (public or private) affiliated either to the IMSS or the ISSSTE who fulfil the requirements for a pension. The federal government guarantees this minimum in the event that the value of the worker's accumulated retirement account balances is not sufficient to finance a minimum pension level. The amount of this minimum guaranteed pension (*pensión mínima garantizada*, PMG) is lower for private-sector workers affiliated to the IMSS (equivalent to MXN 31 211.52 annually as of December 2014) than for public-sector workers affiliated to the ISSSTE (equivalent to MXN 48 650.04 annually as of December 2014). The PMG is adjusted every year to the Consumer Price Index. The guaranteed pension is paid in the beginning with the existing balance in the individual account, and when this balance is depleted, is funded from the federal budget.

In case the accumulated balances in the worker's individual retirement account are sufficient to finance a minimum pension level, the worker can choose between two pension modalities:

- Life annuity: The worker signs an irrevocable contract with the insurance company of his/her choice to buy an annuity. Under this contract, the worker transfers ownership of his/her funds in the individual account to the insurance company and the latter commits to pay him/her a monthly pension for life, indexed to inflation. A life annuity can only be bought by workers who have enough funds to obtain a pension that is equal to or higher than the guaranteed pension in effect at the time that he/she chooses this modality.

- Programmed withdrawals: In this case, the worker's balance in the individual retirement account is still managed by the AFORE and therefore continues to obtain the returns of the corresponding SIEFORE. The AFORE pays the pension through monthly withdrawals from the individual account until its balance is depleted. The amount of the monthly payment is adjusted annually taking into account the life expectancy of the pensioner at the time of the recalculation and the new balance in the individual account, which includes return earned in the last period and discounting the payments made. However, payments are not adjusted to inflation. The amount of the programmed withdrawal plan cannot be lower than the guaranteed pension. If in the periodic recalculation, the resulting amount were below the guaranteed pension, the AFORE would pay the pensioner a monthly amount equivalent to the guaranteed pension until the balance is depleted. Finally, the pensioner who opts for programmed withdrawals can buy at any time a life annuity if the life annuity value can be funded with the remaining balance.

Notwithstanding age, if the worker has accumulated enough assets to buy a life annuity equivalent to 1.3 times the minimum guaranteed pension, he or she has the right to buy such an annuity and withdraw the rest of the assets as a lump sum.

Table 2.4 summarises the different retirement benefit options for IMSS and ISSSTE affiliates.

Table 2.4. **Retirement benefit options for IMSS and ISSSTE affiliates**

Age	Required contribution period		Accumulated assets in individual account	Retirement income
	IMSS	ISSSTE		
65	< 1 250 weeks	< 25 years	Total balance	Lump sum
65	> 1 250 weeks	> 25 years	Life annuity* < PMG	PMG
65	> 1 250 weeks	> 25 years	Life annuity* > PMG	Programmed withdrawals or life annuity
	> 1 250 weeks	> 25 years	Life annuity* > 1.3 × PMG	Life annuity of 1.3 × PMG and rest as a lump sum

Note *: The life annuity that the individual can afford with his or her account balance.

Early retirement between 60 and 64 years old is possible provided that the worker is not employed and has contributed at least 1 250 weeks for private-sector workers (respectively 25 years for public-sector workers).

Private-sector workers are entitled to make partial withdrawals from the balance in their individual account in two cases: unemployment or marriage. Public-sector workers are entitled to make partial withdrawals from the balance in their individual account only in case of unemployment. These withdrawals also reduce weeks of contributions.

2.4. Special pension schemes

State-owned companies (e.g. the oil company PEMEX and the Federal Electricity Company), the Armed Forces, IMSS, teachers, Courts (e.g. the Supreme Court and the Federal Council of Justice), the Central Bank and the development banking institutions, have their own pension scheme for their employees. These systems have different

features. Some are DB schemes, while others have migrated to DC schemes at least for new employees.

Local governments (31 sovereign states, one federal district and about 2 450 municipalities) and the 55 public universities also have their own pension schemes, mostly DB and without portability. Moreover, there is no interaction between the federal and the local systems.

2.5. Voluntary pension savings

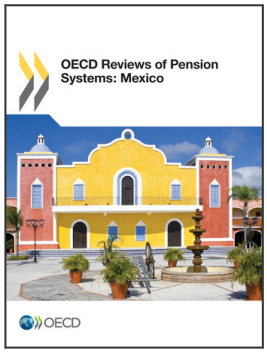
Any worker can make four types of voluntary contributions into their individual accounts as follows:

- Short-term voluntary contributions: These contributions can be withdrawn partially or entirely before retirement. The minimum period to hold these contributions in the individual account is from two to six months after being made, depending on the AFORE.
- Complementary contributions to individual retirement accounts: These contributions can only be withdrawn at retirement as a lump sum or can supplement the worker's pension. They may be deducted from income tax up to four times the minimum annual salary or 10% of annual incomes, whichever is the lowest.
- Long-term voluntary contributions: These contributions can only be withdrawn at retirement age or in the event of disability or incapacity for remunerated work. They may be deducted from taxable income on the same fashion as the complementary retirement contributions.
- Contributions to special "savings for retirement" accounts: These contributions allow the deferral of tax payments until their withdrawal, which can be made after at least five years have elapsed from the date of the voluntary contribution. The maximum annual amount of contributions qualifying for tax exemption is MXN 152 000.

In addition, those public-sector employees who are affiliated to the ISSSTE benefit from a very generous matched-contribution scheme called Solidarity Savings (Ahorro Solidario). This scheme gives workers an attractive incentive to make voluntary contributions of between 1-2% of their earnings (capped at 10x the minimum wage), with the government adding 3.25 pesos for every 1 peso contributed. A recent reform proposal seeks to provide a similar matching scheme for private-sector workers. It would likely be far less generous, however, with the government only adding 20 cents for every 1 peso contributed, up to a 300-pesos annual limit (less than 1% of the minimum wage).

Notes

1. The Social Security Law establishes the mandatory pension scheme for private-sector employees, regulates coverage, contributions and the relationship between the old publicly-managed social security scheme and the mandatory private pension scheme. The SAR Law defines the structure and powers of CONSAR and regulates the establishment, operation and supervision of the AFORE and the SIEFORE.
2. The ISSSTE Law sets the mandatory pension system for Federal employees, regulates coverage, contributions and provides parametric reforms to the old system to regulate the provision of defined benefit pensions from the old system.
3. The amount is set according to the so-called "well-being lines" calculated by the social agency in charge of measuring poverty (CONEVAL). For more information, visit: www.coneval.gob.mx.
4. These two social security institutes provide not only pension-related services (old-age, severance at old-age and retirement insurance) but also health care services (including maternity, childcare and disability).
5. The worker can also change AFORE before one year under specific circumstances.
6. Active accounts are defined as those that received at least one contribution during the last three years.
7. There is no portability between any of the two old DB systems, neither between the old and the new schemes.
8. Resources in the housing sub-account are managed by the INFONAVIT and only appear in the AFORE statement for information purposes.
9. ISSSTE affiliates who started to contribute before 2007 but were inactive when the Law was passed did not have the right to choose between the two systems when re-entering the system. They automatically had to switch to the new DC scheme.



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