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THE AFORE IN MEXICO AND ITS RETIREMENT SYSTEM

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Abstract: The historical panorama faced by social welfare in Mexico and the retirement of various generations of workers in our country, from those who achieved the prodigious retirement, a term that today, little by little, has been displaced to give way to the AFORE generation, which will have access to its replacement rate only through tripartite contributions, that is, from themselves, their employers, as well as from the federal government; However, the central part will be left to the workers themselves, who must be aware of this reality in order to take ownership of it, thus allowing them to take the tools required to provide adequate and strategic retirement planning. It is important to point out that there are external factors of a macroeconomic nature that could have an indirect or direct impact on the ability to provide workers with the long-desired pension; therefore, it is essential to obtain as much information as possible in this regard to enable the alternatives required to achieve an objective, in this case, the full enjoyment of the much-deserved retirement. In order to achieve all of the above, a reminiscence will be made to clarify the background that laid the foundation on which our current retirement savings system was built, reformed and continues to be designed, in order to make the most of it so that the population can retire to rest enjoying the monetary amount required to preserve and even increase their quality of life.

Keywords: AFORE, retirement, pension

INTRODUCTION

For years, the Mexican pension system has been subject to reforms aimed at balancing at least three public policy objectives. First, to expand coverage and access to the retirement savings system. Second, to improve the replacement rate so that workers have a pension sufficient to cover their needs during retirement. Third, to reduce pressures on public finances to reduce the risk of financial unsustainability of pension subsystems based on non-contributory or defined benefit models. However, the pension system still requires substantive reforms if more workers are to have access to the retirement savings system and a better retirement.

The Retirement Savings System (SAR) in Mexico is based on the creation of “individual accounts to which the worker, the employer and the Federal Government contribute. Each worker is entitled to a pension at the end of his or her working life based on the amount accumulated in his or her individual account, which is managed by private institutions called Administradoras de Fondos para el Retiro (AFORES)” (Gómez Hernández and Banda Ortiz, 2013:173). These companies receive the funds and invest them in Sociedad de Inversión Especializada en Fondos para el Retiro (SIEFORES), which in turn invest the resources to generate returns. The National Commission for Retirement Savings (CONSAR) reports that in Mexico there are 10 AFORES, which manage millions belonging to just over 72 million workers’ accounts (CONSAR, 2022).

“A comprehensive public policy on the subject must address various issues to expand coverage, reduce pressure on public finances, improve the replacement rate, encourage voluntary savings for retirement and regulate the dynamics and competition in the Afores market” (Alaniz Gutiérrez, 2019:4). However, it is not possible to reform everything at the

same time. In recent years, modifications have been proposed and, sometimes, approved that seek to solve some of the biggest challenges of the retirement savings system. The following waves of pension system reforms will have to be strategic and prioritized according to their level of complexity, potential impact, and political feasibility

The Retirement Savings System (SAR), in accordance with Article 3, Section X of the Retirement Savings Systems Law, is the system regulated by the Social Security Law, which provides for the contributions of workers, employers and the Federal Government in the individual accounts owned by workers, in order to accumulate resources to obtain pensions for social welfare purposes.

MEXICAN FINANCIAL SYSTEM

The Mexican Financial System (SFM) is understood, in general terms, as the set of authorities that regulate and supervise it, multiple and development banks, multiple purpose financial companies (SOFOMES); Brokerage Houses, Stock Exchanges, Exchange Houses, Insurance Companies, Retirement Fund Administrators (AFORES), Popular Savings and Credit Financial Companies (SOFIPOS), Popular Savings Banks, Credit Unions, and the recent Financial Technology Institutions (IFT), among others. (CONDUSEF, 2022).

This analysis describes the main institutions of the Mexican financial system that intervene as actors, regulators, and as service and/or defense of the users of the retirement fund managers, without further ado we will begin our tour with the central bank of our country.

BANK OF MEXICO

The Banco de México, which opened its doors on September 1, 1925, was the consummation of a long-cherished desire of the Mexican people. Its creation closed a long period of instability and monetary anarchy, which began at the beginning of the 19th century, and during which a system of plurality of banks of issue reigned; a system that was further aggravated by the revolutionary conflict of 1910, and with which came the distrust in paper money and the destruction of the monetary system in force up to that time.

Thus, Banco de México was inaugurated in a solemn ceremony on September 1, 1925. The ceremony was presided over by the first president, Plutarco Elías Calles, and was attended by the most outstanding political, financial and business personalities of that time. The newly created Institute was given the exclusive power to create currency, both through the minting of metal pieces and the issuance of banknotes. As a consequence of the above, it was charged with regulating monetary circulation, interest rates and the exchange rate. Likewise, the new body became the agent and financial advisor and banker of the Federal Government, although commercial banks were left free to associate or not with the central bank.

Banco de México's autonomy is based on three pillars. The first is of a legal nature. At its core is the constitutional mandate that establishes that the Bank's priority mission is to maintain the purchasing power of the national currency. This objective is also specified in Banco de México's current law, enacted at the end of 1993.

The second pillar lies in the way in which its Board of Governors is integrated and the rules to which its operation is subject. This collegiate body is made up of a governor and four deputy governors, who are appointed by the Executive but cannot be removed from office at their discretion. The terms of office

Mexican Financial System

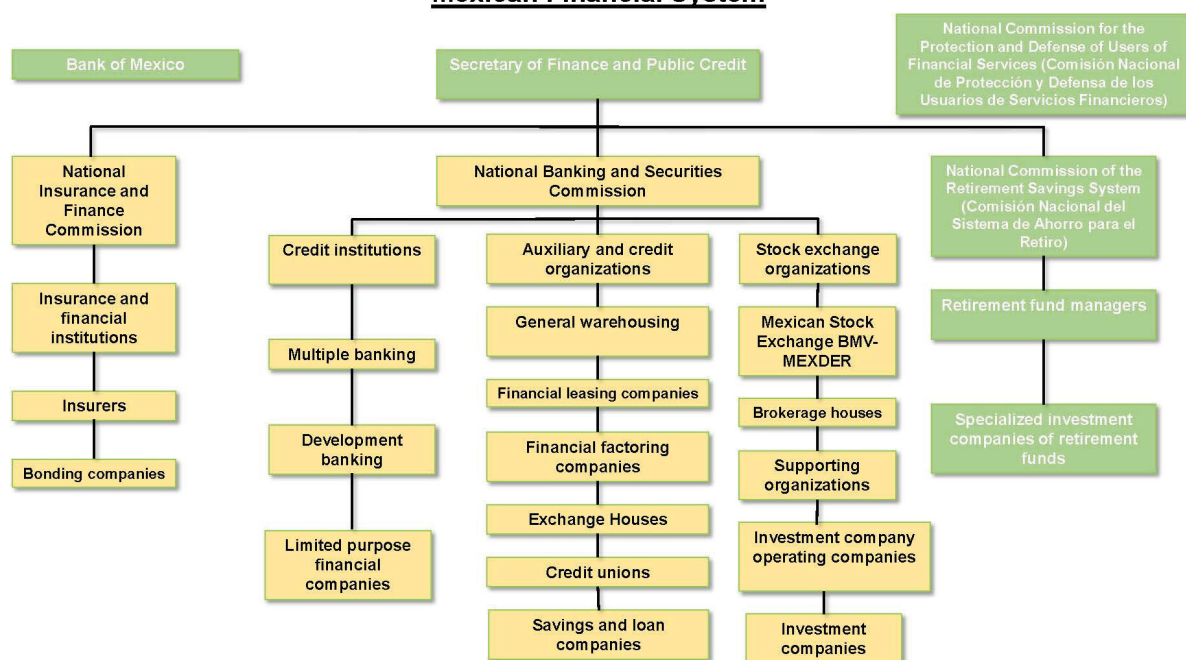


Figure 1. Diagram of the Mexican financial system.

Source: (GOVERNMENT OF MEXICO, 2022)

of these officers alternate. The term of office of the governor is six years and begins in the middle of one six-year term and ends at the close of the first three years of the following six-year term. The terms of office of deputy governors are eight years and are replaced every two years, on an alternating basis.

The third pillar of autonomy is the administrative independence granted to the central bank by law. (BANXICO, 2022))

SECRETARY OF FINANCE AND PUBLIC CREDIT

The Ministry of Finance and Public Credit is an institution in charge of promoting and maintaining a healthy and adequate balance in the development of the Mexican financial system, with the purpose of protecting the assets of customers and users, through the supervision of the institutions that make up the Mexican financial system CNBV, CNSF, Banco de México and CONSAR and in support as advice and recommendations to

many of these institutions is the CONDUSEF (National Commission for the Protection and Defense of Users of Financial Services) and IPAB (Institute for the Protection of Bank Savings).

The Ministry of Finance and Public Credit (SHCP), based on the: Sections VI, VII and VIII of Article 31 of the Organic Law of the Federal Public Administration, is responsible for carrying out or authorizing all operations involving the use of public credit; planning, coordinating, evaluating and overseeing the country's banking system, which includes the Central Bank, the National Development Bank and other institutions in charge of providing banking and credit services; and exercising the powers set forth in the laws on insurance, bonds, securities and auxiliary credit organizations and activities. (CONDUSEF, 2022)

The Ministry of Finance and Public Credit is in charge of planning, coordinating, evaluating and overseeing the country's financial system; this institution determines

and directs, through public policies, the operation of the national financial system. (MINISTRY OF FINANCE AND PUBLIC CREDIT, 2022)

CONDUSEF

The National Commission for the Protection and Defense of Financial Services Users (CONDUSEF) is an effective body for the protection and defense of the interests and rights of users before financial institutions.

FUNCTIONS

- Management: (Ordinary or Electronic): Financial institutions receive user issues or complaints electronically for amicable resolution.
- Conciliation: CONDUSEF finds through dialogue between the user and the financial institution, solution alternatives for their problem. If an agreement is not reached, the rights of the parties are safeguarded by means of a document and the user may request a Technical Opinion.
- Technical Opinion: Contains a technical and legal valuation to be asserted before the competent courts.
- Free Legal Defense: The user may request legal defense whenever there are sufficient legal elements and the user does not have the economic means to hire a lawyer. (CONDUSEF, 2022)

CONSAR

CONSAR is the National Commission of the Retirement Savings System and its main task is to regulate the Retirement Savings System (SAR), which consists of the individual accounts in the name of the workers managed by the AFOREs.

CONSAR establishes the rules for the SAR to function properly.

Ensures that workers' resources are adequately safeguarded.

Oversees that workers' funds are invested in accordance with the parameters and limits established by the Commission (Investment Regime).

Ensures that they provide the required information for workers (that they are sent their statement three times a year).

It is empowered to impose fines on the AFOREs and sanctions on their employees in the event of non-compliance. With all this, it ensures not only that the SAR works, but also that workers' rights are respected by the AFOREs. (CONSAR, 2022)

The word AFORE stands for Administradora de Fondos para el Retiro. It is an institution in charge of managing workers' retirement funds. Article 18 of the Law of the Retirement Savings Systems states that the definition of AFOREs is as follows: "They are financial entities constituted as commercial companies that are exclusively, habitually and professionally engaged in managing individual accounts and channeling the resources of the sub-accounts that comprise them in terms of the social security laws, as well as managing investment companies" (Law of the Retirement Savings System, 1996:12).

Retirement fund managers (afores) are financial entities created to safely manage and invest workers' retirement resources and thus improve their pension conditions; although banks own some afores, they are neither banks nor insurance companies.

The National Commission of the Retirement Savings System (CONSAR), the government agency in charge of supervising the afores, a worker in the public, private or independent sector has the right to open an account with any of the 10 fund managers in the market.

Each worker has an individual account that is personal and unique. Throughout the working life of each worker, the contributions and dues made periodically by the employer, the government and the employee are accumulated.

The reform to the Social Security Law in 2020, contributions will be increased gradually starting in 2023. The increase in the percentage of tripartite contributions will go from 6.5% to 15% of the Base Contribution Wage. In the breakdown, employers will contribute 13.875%; workers, 1.125%; and the government, 0.225 percent.

In addition, each retirement savings account is subdivided into four subaccounts: Retirement, Old Age and Severance, Voluntary Contributions, Housing and Additional or Complementary Contributions.

There are currently more than 70.4 million afores accounts; however, more than 18.1 million workers are unaware that they have a retirement fund account. In addition, the total amount of money managed by the afores is 5.1 trillion pesos.

In 2021, the Siefiores' investment portfolio was 50.8% in government debt, 15.0% in domestic private debt, 14.4% in international equities, 6.7% in structured securities, 6.5% in domestic equities, 2.6% in Fibras, 0.7% in international debt, 0.4% in commodities and 3.0% in assets other than those mentioned above. (Nolasco, 2022)

SIEFORES

SIEFORE is an Investment Company Specialized in Retirement Funds (SIEFORE), through which the Retirement Funds Administrators (AFORE) invest the resources of workers. Each SIEFORE represents a combination of different investment assets that seeks to obtain the highest possible returns on your savings. In 2019, AFOREs migrated from a multi-fund scheme to a life-cycle model (Generational SIEFOREs). In the previous scheme,

workers were grouped in five SIEFOREs and as they reached the age limit established in each Society, they migrated to the next fund. In contrast, the new scheme concentrates workers in ten groups, with five-year age cutoffs and identified by year of birth. In this way, they remain in the same SIEFORE throughout their working lives and allow account holders to capture the returns on their long-term investments. (AFORE SURA, 2022)

AMAFORE

The Asociación Mexicana de Administradoras de Fondos para el Retiro, A.C. (AMAFORE), is a civil association founded in 1997 to strengthen and consolidate the Retirement Savings System (SAR). It represents its members, the Administradoras de Fondos para el Retiro (AFORES), in order to achieve the development of the industry and the consolidation of a sustainable national retirement savings system.

In AMAFORE we work to promote the SAR, its understanding and thus deepen access and broaden its use; we promote financial education initiatives with emphasis on savings and investment; we develop discussion forums to identify best practices in the administration of Retirement Savings Systems; we promote research and the creation of tools as well as the construction of strategic alliances; we encourage dialogue to improve the pension system and seek to promote regulatory and economic policies in accordance with principles of equity, in search of a better retirement for workers in Mexico. (AMAFORE, 2022)



Figure II. Main functions and commissions of AMAFORE 2022. (AMAFORE, 2022)

OPERATION OF THE AFORE

When a person registers with an administrator, the AFORE opens a unique and personal account, commonly called “Individual Account”. This is where the contributions that are periodically deposited by the employer, the government and the worker are accumulated. The contribution is calculated based on your base salary and varies depending on whether you belong to the public sector (ISSSTE) or the private sector (IMSS).

As mentioned above, the individual account is the personal and unique account belonging to each worker where the mandatory contributions and quotas corresponding to retirement savings made by the employer, the Federal Government and the worker are deposited. Voluntary contributions made by the worker are also accumulated to increase his/her balance. This account is managed by a Retirement Fund Administrator (AFORE).

IMSS

Employer: 2% of the base contribution salary for retirement and 3.15% for severance at advanced age and old age. In total, the employer contributes 5.15% to the RCV subaccount. In addition, the employer contributes 5% of the contribution base salary to the employee’s housing subaccount.

Employee: 1.125% of the employee’s contribution base salary for severance at advanced age and old age.

Government: contributes 0.225% of the employee’s base salary plus an additional social contribution for each day of salary contributed, capped for workers earning up to fifteen times the minimum salary. The social contribution is updated quarterly in accordance with the NCPI.

ISSSTE

Entities or agencies: 2% of basic salary for retirement and 3.18% for severance at advanced age and old age. In total, the agencies or entities contribute 5.17% to the RCV subaccount. In addition, 5% of the basic salary is contributed to the employee’s housing subaccount.

Employee: 6.13% of basic salary for severance at advanced age and old age.

Federal Government: Contribution of 5.5% of the general minimum wage in effect as a social contribution.

Both IMSS and ISSSTE contributors, as well as self-employed workers, can make Voluntary Savings, which can complement retirement savings.

Once the AFORE receives these contributions, it invests them through Investment Companies Specialized in Retirement Funds (Siefors). Since December 13, 2019, these Siefors are generational, i.e., the resources are grouped depending on the age of the workers and are invested with a retirement date perspective.

The AFOREs invest in financial markets (domestic and international, debt and equity), subject to an investment regime designed by the National Commission of the Retirement Savings System (CONSAR) to reduce risk and maintain diversified portfolios.

The returns generated by such investment will be reflected in the balance of the workers’ individual retirement savings account.

The investments made by all AFOREs are regulated by CONSAR.

An AFORE performs seven main functions, which are:

1. Receive employee and employer contributions for Retirement, Severance and Old Age Insurance (RCV), as well as voluntary savings from workers or employers.
2. Individualize the contributions and yields of individual retirement savings accounts.
3. Invest workers' resources in the different SIEFORES GENERACIONALES.
4. Send account statements to workers every four months.
5. Pay scheduled withdrawals.
6. To deliver the resources to the insurance institution that the worker or his beneficiaries have chosen, for the contracting of life annuities and/or survivorship insurance.
7. To assist and advise the employee in all the procedures and services related to his account.

The first three functions are substantive because they are the ones that give meaning to the existence of the AFORES, while the rest of the functions are of service to the workers registered in them.

COMPOSITION OF THE INDIVIDUAL ACCOUNT

The Individual Account is made up of several subaccounts that include: retirement, voluntary contributions, complementary contributions and the housing subaccount. Alanís Gutiérrez (2019) explains the subaccounts, as outlined in the following sections.

RETIREMENT, SEVERANCE AND OLD AGE PENSION (RCV)

In this subaccount are deposited the tripartite quotas and contributions, i.e., those made by the employer, the Federal Government and the worker.

VOLUNTARY CONTRIBUTIONS

Voluntary Contributions Subaccount. This subaccount records the contributions that the worker makes voluntarily to his/her Individual Account and that will serve as additional savings to increase the amount of his/her Individual Account; these can be withdrawn depending on the type of contribution made.

Making Voluntary Contributions to IRAs is one of the best financial decisions for retirement, since it improves the replacement rate. The replacement rate is the percentage that a person will receive as a pension compared to his or her last salary.

In addition, some voluntary contributions can be withdrawn at any time the saver wishes after being deposited if necessary. Contributions may even have tax benefits.

SUPPLEMENTARY CONTRIBUTIONS

Sub-account for complementary contributions. This subaccount reflects the contributions that the Worker voluntarily makes to his Individual Account in the long term; therefore, they cannot be withdrawn until the Worker has the right to receive a pension or has a pension refusal.

HOUSING

Housing sub-account. In this subaccount only the employer deposits bimonthly contributions equivalent to:

IMSS Contributors: 5% of their Base Contribution Salary

ISSSTE contributors: 5% of the Basic Salary

These resources are channeled to INFONAVIT (in the case of IMSS) or

FOVISSSTE (in the case of ISSSTE) through the National Housing Fund. The AFORE keeps the record of these resources and the interest updates on a monthly basis, which appear in the Account Statement.

CONCLUSIONS

The retirement savings system needs to redouble its efforts to make the population aware of the need to save throughout their working lives, otherwise the time will come when we will have an increasingly older generation of elderly people who will not have what they need to meet their basic needs.

Therefore, there is an urgent need to raise awareness among the population and promote a savings culture that will allow the possibility of having a sufficient reserve of resources to provide what is necessary to enjoy retirement in an adequate manner.

In addition, it should become a priority for future government administrations to provide the necessary impetus to allow more workers to enjoy a well-deserved rest with the necessary replacement rate for financial peace of mind.

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