

Mexico pension system overhaul: Afores in the spotlight

Afores' assets under management (AUM) set to climb from 18% of GDP to around 35% in 2030

The need to upgrade Mexico's pension fund system

Mexico's major 1997 pension fund reform established the Afores' system (pension fund managers) as it is known today and allowed the Mexican economy to better finance pensions. It created a new mandatory contribution system of individual accounts for private-sector workers, where Afores started managing worker's savings through specialized investment funds for retirement¹. In only 25 years, the Mexican Pension Fund System, currently made up of ten Afores, has grown to manage USD 352 billion in assets, the equivalent of around 19% of GDP, in 2023. Their assets under management (AUM) have grown rapidly at an average annual pace of 14% y/y since 2000².

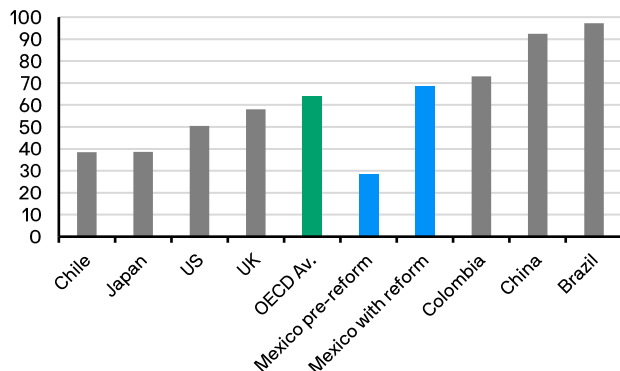
Despite the growth in assets and progress towards more adequate pensions, there was still room for improvement. The Mexican pension fund system's 6.5% total contribution rate was one of the lowest in the world among countries with defined contribution plans, ranking 31 out of 33 OECD members with available data³. As a result, Mexico had one of the lowest replacement rates globally, which drove many companies to offer private pension plans to supplement the insufficient public plans. The OECD estimated that the average contribution rate of 6.5% would allow a salaried worker to reach a replacement rate of just 26% by retirement, well below the average replacement rate for OECD countries of 64%⁴.

2020 Reform to overhaul the system and boost Afores' AUM

Aiming to tackle these challenges, the Mexican government unveiled a comprehensive new reform to its pension system in 2020. To boost contribution rates to levels in line with the OECD average, the government approved plans to increase mandatory contribution rates from 6.5% in 2023 to 15% by 2030. Afores' management fees will be capped at 0.57%, and the number of minimum weeks of work required to receive a government pension plan will be lowered to ensure a more secure retirement for workers. With the reform, the OECD estimates Mexico's average replacement rate has improved to 67%.

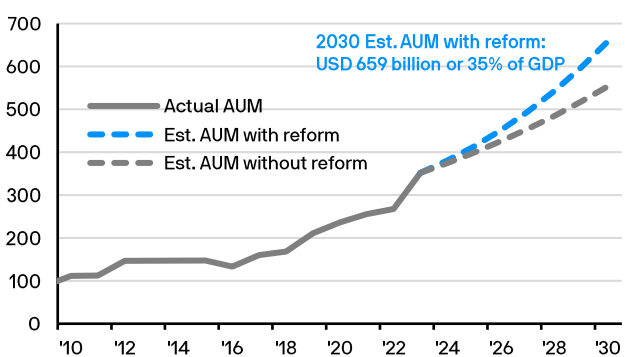
Crucially, the 2020 reform will result in substantial growth for the Afores System. We estimate the Afores' AUM will rise from 19% of GDP in 2023 to 35% by 2030⁵. In other words, Afores' AUM will increase by almost 207% over the next 7 years according to our model. This represents a jump in assets from MXN 6.0 trillion in 2023 to MXN 16.0 trillion in 2030, or from USD 352 billion to USD 659 billion. Without the Reform, Afores' AUM would still grow due to solid returns and a minor increase in working age population, but the higher contribution rates thanks to the reform do imply a meaningful additional boost to Afores' AUM of 6% of GDP over the next seven years. It will also increase Afores' demand for Mexican and foreign assets and support the development of Mexico's financial system, of which Afores represents about 17%⁶. While challenges to improve pension coverage still remain, especially considering Mexico's informal sector and high number of inactive pension accounts⁷, the 2020 Reform represents noteworthy progress toward elevating replacement rates, improving social security access and further developing the Afores' system.

Figure 1. Selected OECD countries replacement rates (%)



Source: OECD (2021), *Pensions at a Glance 2021: OECD and G20 Indicators*, OECD Publishing, J.P. Morgan Asset Management. Data as of 2021.

Figure 2. Afores' historical and estimated AUM



Source: CONSAR, J.P. Morgan Asset Management. Forecasts start as of 2023. For illustrative purposes only. The estimate methodology is detailed in page 2. Data as of February 20 2024.

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The 2020 Mexico Pension System Reform in detail

In December 2020, the Social Security Law and the Retirement Savings Systems Law were amended in 2 key areas:

- The contribution rate for each account will increase from 6.5% in 2023 to 15% in 2030. Employer contributions will increase from 5.15% to 13.875% while employee contributions are unchanged at 1.125% of their annual base salary. Employer contributions are eligible for salaries greater than 4.01x the Unit of Measure and Update used in Mexico (current set at MXN 103.74 daily value)⁸. Meanwhile, government contributions will only benefit lower income workers and will range from 8.724% (for salaries less than or equal to the minimum wage, currently set at MXN 207.44⁹) to 1.798% (for salaries up to 4x the Unit of Measure and Update), thus guaranteeing pension benefits.
- The Afores' annual management fee will be capped at 0.57% starting in 2023. This fee level was determined by CONSAR by calculating the average pension fees in the U.S. (0.6%), Colombia (0.5%) and Chile (0.6%). The new capped fees are down from 1.0% in 2018 and are at historical lows.

A model to forecast Afores' AUM with J.P. Morgan AM LTCMAs and expected contribution flows

Methodology and assumptions

The Afores' end-2023 AUM of MXN 6,0 trillion is used as a starting point. The model assumes AUM will increase each year by 1) returns net of commissions and 2) flows from individual account contributions, as follows:

$$AUM_{T1} = AUM_{T0} \times (1 + (\text{Returns}_{T1} - \text{Fee}_{T1})) + \text{Account Contribution Flows}_{T1}$$

Returns net of fees

- Total expected returns are derived using J.P. Morgan Asset Management's 2024 Long Term Capital Market Assumptions in MXN. They are calculated using the expected returns of asset classes over a 10- to 15-year time frame and are weighted according to Afores' average exposure to that asset class (see Figure 3).
- A fee of 0.57% is subtracted from the total return each year.

Account contribution flows

- The second part of the model aims to estimate total annual flows of individual accounts in MXN. The model uses the 2023 number of existing accounts of 72,179,613 as the starting point and applies a growth rate each year to estimate the total number of accounts.
- Existing accounts have increased by 2.1 million, or 3% y/y on average for the past three years. In line with J.P. Morgan Asset Management's LTCMAs and the UN Population Division data, the growth in working age population is expected to decrease gradually from 1.4% per year (average from 2012 to 2021) to an average of 0.9% from 2023 to 2034. Therefore, the growth in accounts on a net basis are expected to gradually decline from 3% in 2023 to 0.9% in 2030.
- Given the large informal sector with Mexico's economy and the high number of inactive accounts, an attrition factor is included. The model applies a conservative assumption that only 40% of existing accounts will actively receive pension contributions.
- Finally, to calculate annual contribution flows from existing accounts each year, mandatory contributions are expected to go from 6.5% in 2022 to 15% in 2030 in line with the 2020 Reform changes. The model assumes they increase in a linear manner and that 2023 is the first year with a higher contribution rate of 7.56%.
- To calculate the average contribution per account, the model uses an estimate for average annual salary. The average annual salary per person is also adjusted by the estimated level of inflation for each year. The 2022 average annual wage of MXN 124,083 published by the Mexican Institute of Social Security (IMSS)¹⁰ is used as the starting point. The long-term Inflation forecast for the Mexican economy of 3.7% is sourced from J.P. Morgan Asset Management's 2024 LTCMA.
- The mandatory contribution rate each year is multiplied by the average annual wage per person to obtain an average contribution flow per account and to ultimately estimate total flows for existing and net new accounts each year, assuming an attrition rate.

Other considerations

- To calculate expected AUM in USD terms, the long-term USD-MXN FX forecasts is sourced from J.P. Morgan Asset Management's 2024 LTCMAs. These expect the MXN to reach a fair value of 27.49 by 2023, so a FX rate based on this assumption is interpolated for the forecast years between 2023-2030. For more information on the methodology used to calculate fair value and currency assumptions please refer to the J.P. Morgan AM 2024 LTCMAs.
- To calculate expected AUM as a % of GDP, Nominal GDP forecasts for 2023-2030 are calculated using J.P. Morgan Asset Management's 2024 LTCMA long term forecast for Mexico GDP growth (2.0%) and inflation (3.7%). While actual growth and inflation rates may fluctuate each year, the LTCMA forecasts are used as they estimate average growth and inflation over a 10- to 15- year time frame.

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Figure 3. J.P. Morgan AM LTCMA expected returns and asset class weight assumptions in Afores' portfolios

Asset Class	2024 LTCMA Assumptions in MXN	Assumption of weight in Afores' portfolio
Mexican Equity	9.40%	7%
Mexican Government Debt	8.40%	65%
US Large Cap Equities	11.00%	10%
Asia Ex Japan Equities	12.50%	10%
EAFE Equity	12.80%	5%
Private Equity	13.00%	3%
Total expected return in MXN	9.46%	

Source: CONSAR, J.P. Morgan Asset Management. The 2024 LTCMA assumptions returns refer to the expected returns of asset classes over a 10- to 15-year time frame published in the 2024 edition of J.P. Morgan Asset Management's Long Term Capital Market Assumptions. As of June 2023, according to data published by CONSAR, Afores AUM by asset class was as follows: Mexican Government Bonds (51%), Mexican Corporate Bonds (15%), International Equities (12%), Structured Assets or Alternatives (8%), Mexican Equities (7%), REITs (2.9%), International Bonds (1%), Commodities (1%), Other (4%). Given J.P. Morgan AM LTCMAs in MXN are not available for all these asset class, assumptions for weights of included asset classes were made as per table above.

Figure 4. Additional assumptions applied to the model to estimate Afores' AUM

Year	Mandatory Contribution	Fees charged by Afores	Growth of net new Accounts	Av. annual wage per person (MXN)	USD-MXN
2023	7.56%	0.57%	3.00%	128,674	16.97
2024	8.63%	0.57%	2.70%	133,435	18.02
2025	9.69%	0.57%	2.40%	138,372	19.07
2026	10.75%	0.57%	2.10%	143,491	20.13
2027	11.81%	0.57%	1.80%	148,801	21.18
2028	12.88%	0.57%	1.50%	154,306	22.23
2029	13.94%	0.57%	1.20%	160,016	23.28
2030	15.00%	0.57%	0.90%	165,936	24.33

Source: CONSAR, J.P. Morgan Asset Management, IMSS, Bloomberg. A detailed description of the assumptions is included in page 2.

Figure 5. Summary of Afores' AUM growth model estimates including impact of 2020 Pension Plan Reform

Year	Afores AUM (MXN billion)	Afores AUM (USD billion)	AUM as a % of GDP
2023	5,976	352	19%
2024	6,857	380	21%
2025	7,886	413	23%
2026	9,082	451	25%
2027	10,469	494	27%
2028	12,071	543	29%
2029	13,917	598	32%
2030	16,037	659	35%

Source: J.P. Morgan Asset Management. The estimated AUM from 2023 to 2030 for Afores as a result of the 2020 reform are based on a model developed by the Market Insights team at J.P. Morgan Asset Management. For illustrative purposes only. Actual results may vary depending on a series of economic factors and developments. The methodology and assumptions of the model are detailed in page 2 and 3.

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Footnotes:

¹The new mandatory contribution system of individual accounts for public workers was established in 2007. The specialized investment funds for retirement that Afores manage are called Siefores.

² Source: Consar

³Source: OECD (2021), Pensions at a Glance 2021: OECD and G20 Indicators, OECD Publishing,

⁴Source: OECD (2019), Pensions at a Glance 2019: OECD and G20 Indicators, OECD Publishing,

⁵The estimated AUM in 2030 for Afores as a result of the 2020 reform are based on a model developed by the Market Insights team at J.P. Morgan Asset Management and are intended for illustrative purposes only. The methodology and assumptions of the model are detailed in page 2 and 3.

⁶According to Banco de Mexico data published by J.P. Morgan CIB Research as of 2021.

⁷According to INEGI, the informality rate of the Mexican Economy is approximately 56% as of Q2 2023. According to Consar, approximately 55% of accounts registered at IMSS are inactive while 30% of accounts registered at ISSSTE are inactive as of June 2023.

⁸ The Unit of Measure and Update (Unidad de Medida y Actualización, or UMA by its acronym in Spanish) serves as the basis for calculating the payments, obligations, or penalties that are owed to the government, whether under federal or state law, and was adopted as an economic reference unit in 2016. The UMA values have implications for tax and social security contribution determinations. On 9 January 2023 Mexico's National Institute of Statistics and Geography (INEGI) published the new values for the Unit of Measure and Update that took effect on February 1, 2023 for 2023: Daily (MXN 103.74), Monthly (MXN 3,153.70), Annual (MXN 37,844.40).

⁹ The 2023 daily minimum salary in Mexico was set at MXN 207.44 by the Mexican Government.

¹⁰ According to the Mexican Institute of Social Security (IMSS), the daily average salary in Mexico in 2022 was MXN 486.60. This translates to an annual average of MXN 124,083 if 255 working days in the year are considered.

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