

Public policy recommendations to improve retirement savings



Mexican Retirement Savings Regulation History

Before 1997

Defined Benefit System: pension payments were based on the employees' average salary for the last five years of work. Replacement rate of 100%.

After 1997

The system changed from Defined Benefit to Defined Contribution where each person saves for his or her own retirement in individual accounts. Replacement Rate. Depends on the number of years worked, base salary, mandatory and voluntary savings.

2020 Improvements

Improving access to pensions. Decrease in number of contribution weeks to be eligible for Pension. From 1,250 to 750 weeks with a gradual increase to reach 1,000 weeks in 2031 to be eligible for a Pension.

Increase in mandatory savings rate. From 6.5% in 2021 to 15.0% in 2031.

Non-contributive guaranteed pension Increases from 3,289 to 4,345 Mexican pesos per month.

Improve Replacement Rate. Increase from 40% to 100% in lower income savers. Improvement given increase in mandatory savings rate.

Three theoretical approaches to public policy recommendations:

1. Life cycle. Individuals are rational and seek optimal consumption throughout their life to accumulate sufficient resources during their working years to finance their consumption during retirement .

2. Financial education. Knowledge and understanding of basic economic and financial concepts can improve workers' retirement decisions.

3. Behavioral economics. Individuals make decisions with incomplete information, have limited cognitive capacity, are loss averse and make decisions subject to framing. This theory seeks to alter these behaviors with nudges improving the decision-making process, leading to better retirement outcomes .

13 Public Policy Recommendations



For the retirement savings system:

1 Voluntary retirement savings plans with automatic enrollment and *opt-out* option.

- Use of nudges to eliminate friction points in the creation and accumulation of retirement savings

2 Retirement savings account balance.

- Use of accumulated account balance to acquire a pension when workers don't meet the minimum contribution weeks (CONSAR, 2022).

3 Institutional strengthening

- Organizational coordination.
- Portability of savings accounts.
- Simplification of administrative procedures.

4 Use of technologies to incentivize retirement savings.

- Promote the use of electronic devices in applications such as CONSAR's Afore-Móvil.

For the labor market:

5 Increase formal labor market.

- Lower barriers of entry to the formal sector.
- Improve education and skills from an early age.

6 Incorporate informal workers to mandatory contributions

- Change requirements for informal workers to access social security and mandatory pension system

For financial inclusion:

7 Automatic enrollment to AFORES as part of other government procedures

- Enrollment to mandatory retirement savings programs as part of the official ID issuance process or other administrative procedures.

8 Use of technology

- In addition to the **Fintech Act (2017)**, promote policies that **accelerate digital financial services** (Chamber of Representatives, 2022).

On the non-contributive pension program:

9 Redesign of the welfare pension

- Access is conditional on administrative efforts. (attending medical consultations).
- Gender perspective (increased support for women).

Regarding the gender gap:

10 Policies to reduce the gender gap in retirement savings (CONSAR, 2022):

- A per-child bonus for mothers that worked in the formal labor market (like in Bolivia, Chile and Uruguay).
- Recognition of contribution weeks or contributions for women that are primary care givers (Argentina and Brazil).
- Pension funds must be considered on divorce settlement procedures for men or women who have worked in the formal market (Chile).
- Gender-neutral mortality tables for calculation pensions (Bolivia, Uruguay and El Salvador),

11 Comprehensive Family Care System. To promote women's participation in the labor market and therefore, improve their retirement savings (Dictionary of Caregiving, OXFAM, 2022):

On the potential market:

12 For formal workers: automatic enrollment in voluntary savings plans

Informal workers: enrollment to savings programs tied to government administrative procedures

Target client: people that live in cities of more than 200k habitants, 18-29 years old, with a college degree and formal job. One of main concerns is saving for emergencies.

In summary,

- Saving for retirement is important from a social perspective. There is a need to provide financial security for Mexicans at retirement age.
- Reforms to the Mandatory Savings System have improved the retirement outlook for formal workers.
- **Public policy recommendations** can improve access to pensions for workers and increase replacement rates to desired levels between 70 and 85% (Vanguard, 2019).

Savings culture:

13 Financial education

- National campaigns to promote voluntary savings and the use of technology.
- Incentivize actions that improve the probability of people to save such as **keeping a budget and obtaining formal credit**, these allow individuals to know the benefits of keeping their money in the formal sector (OECD, 2015).

- All proposed government actions are useful. However, one of the main recommendations is **voluntary retirement savings plans with automatic enrollment and *opt-out***. These type of plans have proven successful in other jurisdictions as they enhance voluntary savings by removing frictions in the accumulation of savings for retirement.