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Changes in the investment regime of retirement fund investment companies

On May 31, the National Retirement Service System Commission (“Commission”) published in the Federal Official Gazette (“FOG”) the General Provisions for the investment regime of specialized retirement fund investment companies (“Provisions”), which entered into force on June 3, with the exceptions provided for in its transitory articles.

The publication of the Provisions repeals all regulations previously issued by the Commission contrary thereto, as well as the prior General Provisions for the investment regime of specialized retirement fund investment companies published in the FOG on January 5, 2018.

The most relevant aspects of the Provisions are:

I. CREDIT QUALITY

Provisions set forth minimum ratings for the following securities:

a) Debt instruments denominated in domestic currency and units.

b) Debt instruments denominated in foreign currencies, placed in domestic or international markets, with the exception of those issued by the Federal Government or the Bank of Mexico.

c) Neutral investment.

d) Foreign debt securities.

e) Debt instruments denominated in domestic currencies and units with ratings on global scale only.

f) Foreign debt securities denominated in domestic currency and units placed in domestic markets with local ratings only.

g) Instruments linked to underlying assets issued in Mexico.

h) Instruments linked to underlying assets issued abroad.

i) Foreign issuers and counterparties of linked components.

j) Domestic issuers and counterparties of components of instruments linked to underlying assets.

k) Counterparties of demand bank deposits.

l) Domestic and foreign counterparties with whom specialized retirement fund investment companies (“Companies”) carry out repurchase agreements (repo), securities or derivatives lending transactions or in which they make deposits.

In case ratings change or a credit rating agency not included in the Provisions is authorized, the Risk Analysis Committee shall analyze the new ratings and determine the necessary modifications.

II. INVESTMENT VEHICLES

Criteria for authorizing investment vehicles, stock indexes, real estate indexes and debt indexes of eligible countries will be defined by the Risk Analysis Committee.

III. INVESTMENT FRAMEWORK

The investment regime shall be determined by the Investment Committee of each Company, and shall be disclosed in the prospectus, with the limitations and under the parameters established by the Financial Risk Committee.

Similarly, the Investment Committee should define an investment trajectory for each trimester, consistent with the age of workers and the long-term investment strategy previously defined.

Failure to comply with the investment framework on grounds attributable to Companies or their agents resulting in the undermining or loss of their total assets, managed assets or investment assets shall be compensated by the fund administrator from their special reserve and, if insufficient, from its share capital. Provisions set forth the procedure for such compensation, as well as cases in which non-compliance may not be considered imputable to the Company or its agents.

IV. INVESTMENT FRAMEWORK FOR BASIC INVESTMENT COMPANIES

Pension fund managers must invest resources in the pertaining Company according to the date of birth of workers and pensioners (target date funds by quinquennial age groups) in accordance with the conditions laid down in the annexes of the Provisions.

Three types of Companies are established:

1. Basic investment companies

2. Initial basic investment company

3. Basic pension investment company

In addition, workers may request the transfer of their resources to a Company other than that corresponding to their age.

• Instruments and operations allowed and prohibited

Basic pension investment companies shall maintain at least 51% of their total assets in debt instruments or foreign debt securities denominated in units or domestic currency, whose interest rate ensures returns equal to or greater than the unit variation or the consumer price index.

Under the conditions and restrictions set out in the Provisions, Basic Investment Companies may invest in the following:

1. Up to 100% of their total assets in:

   a) Debt instruments issued or secured by the Federal Government or the Bank of Mexico.
   b) Debt instruments rated in accordance with the Provisions.

2. Demand bank deposits.
3. Authorized transactions to guarantee derivatives.
4. Up to 20% of their total assets in foreign securities and development fiduciary certificates for projects outside the national territory.
5. Equity components.
6. Real estate investment trusts (REITs) and real estate investment vehicles.
7. Structured instruments.
8. Goods.
9. Foreign debt securities.

Basic Investment Companies may acquire assets directly or through vehicles, derivatives or agents. They may also invest a part of their total assets in securitized instruments and underlying structures. In the latter case, the Basic Pension Investment Companies may not invest in such assets when they are linked to goods.

Basic Investment Companies are not allowed to:

1. Acquire assets issued, accepted or secured by financial institutions or brokerages subject to intervention.

2. Acquire debt instruments, foreign debt securities, REITs or investment vehicles issued, accepted or secured by financial entities or brokerages with which they have equity ties.

3. Acquire debt instruments and subordinated foreign debt securities, with the exceptions set forth in the Provisions.

4. Acquire debt instruments and foreign debt securities convertible into shares, with the exceptions set forth in the Provisions.

5. Acquire foreign instruments and securities that give their holders rights or returns linked to individual shares, sets of shares or variations in the price of unauthorized goods, assets or instruments.

6. Carry out bank deposits and repurchase agreements, lending of securities and derivatives with financial institutions or brokerages with which they have equity ties.

7. Acquire foreign equities different from equity components.

8. Acquire REITs, real estate investment vehicles or securitized instruments in which real estate, assets in rem or rights over trusts have been provided by entities with which they have equity ties.

Regarding risk parameters, Basic Investment Companies must maintain the maximum limits set forth in the Provisions for the following:

1. Errors in monitoring
2. Value at risk
3. Differential of the conditional value at risk (CVaR).

Provisions also define the diversification criteria, their maximum limits and percentages, the procedure for their calculation, ratings and compliance requirements.

V. MERGER OR PORTFOLIO TRANSFER

For a period of 360 calendar days after the merger takes effect, the merging or transferee Company may exceed the maximum limits of risk parameters, provided that the excess is a direct result of the merger or transfer.

During this time, Companies may not acquire more debt instruments, foreign debt securities, instruments linked to underlying assets, REITs or structured instruments of the issue in excess.

VI. TRANSITORY PROVISIONS

Transitory provisions lay down the changes that fund managers must comply with in regard to the name and purpose of Companies, as well as the procedure for transferring resources to the Basic Investment Companies according to the date of birth of the workers, which shall be carried out on Friday, December 13, 2019.

Transitory provisions also determine deadlines and conditions for Companies to be subject to the investment limits and diversification criteria set forth in the Provisions, and where they will continue to apply the former limits.

Full text of the Provisions and annexes can be found in the following link:

https://www.dof.gob.mx/nota_detalle.php?codigo=5561636&fecha=31/05/2019

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