

Pensions & Retirement Plans 2019

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Pensions & Retirement Plans 2019

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Lexology Getting The Deal Through is delighted to publish the seventh edition of *Pensions & Retirement Plans 2019*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on Brazil and Mexico.

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Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

Lexology Getting The Deal Through gratefully acknowledges the efforts of all the contributors to this volume, who were chosen for their recognised expertise. We would like to thank the contributing editor, Jan Van Gysegem, of Claeys & Engels, for his continued assistance with this volume.



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Mexico

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STATUTORY AND REGULATORY FRAMEWORK

Primary laws and regulations

- 1 | What are the main statutes and regulations relating to pensions and retirement plans?

Social Security Law is the main regulation law regarding the pensions. Other regulatory laws are the Law on Retirement Savings Systems – in particular, the General Provisions Applicable to Private Pensions, issued by the National Committee for the Retirement Savings System.

Regulatory authorities

- 2 | What are the primary regulatory authorities and how do they enforce the governing laws?

The Mexican Social Security Institute enforces the law by carrying out inspections of the employers and checking all the information regarding the contributions, salaries and the work done by the employees. This Institute is the one that establishes if a person has the right to a pension and the amount of the pension.

The National Commission of the Savings System for Retirement has the fundamental task of regulating the Retirement Savings System (SAR) the AFOREs, which are the institutions that are in charge of managing the retirement funds (those contributed by law), and they regulate private pension plans.

Pension taxation

- 3 | What is the framework for taxation of pensions?

According to article 93(IV) of the Income Tax Law, this type of income is exempt up to a daily amount of 1,209 pesos (as of 2018).

STATE PENSION PROVISIONS

Framework

- 4 | What is the state pension system?

The Savings System for Retirement (SAR), is a system that is regulated by social security laws. It ensures that the contributions of workers, employers and the State are managed through individual accounts, called AFOREs, which are owned by each worker. The purpose of these accounts is to accumulate resources to finance the workers' pension. Each worker affiliated with the Mexican Institute of Social Security (IMSS) or the Institute of Social Security and Services of State Workers (ISSSTE) has an individual account in which his or her contributions are deposited, those of their employer and those of the government, as well as the returns that are generated from the investment of resources.

Pension calculation

- 5 | How is the state pension calculated and what factors may cause the pension to be enhanced or reduced?

The pension is calculated taking into account the amount saved by the worker in the AFORE and the average lifespan, to pay a monthly pension from the saved amount for the rest of the person's life.

To enhance the pension each worker is able to make a voluntary contribution to the AFORE.

Also, the resources accumulated are invested in a medium to low-risk investment system, but can be changed to a high risk investment system that can both increase or reduce the pension, depending on the results of the investment.

Aims

- 6 | Is the state pension designed to provide a certain level of replacement income to workers who have worked continuously until retirement age?

Yes, right now in Mexico the replacement income is 26.4 per cent of the last salary earned by the worker.

Current fiscal climate

- 7 | Is the state pension system under pressure to reduce benefits or otherwise change its current structure in any way on account of current fiscal realities?

There has been some pressure regarding the low replacement income of the pensions in Mexico. There has been some discussion on whether the percentage of contributions should be increased to increase the replacement income of pensions, but so far there have not been any changes.

The Mexican government is trying to use the funds from the pension system to fund their social welfare programmes.

OCCUPATIONAL PENSION SCHEMES

Types

- 8 | What are the main types of private pensions and retirement plans that are provided to a broad base of employees?

There are several types of private pensions and retirement plans for employees. The most common in Mexico is the 'defined benefit' which is a pension plan where the company defines the remuneration that the employee will receive once he or she has retired, but in recent years, the use of hybrid or mixed plans has become more common.

The second type of private pension plan is the defined contribution where the employee has an individual account, the contribution is decided on by the employer and based on what the employee accumulates, plus the contribution of the company.

The third type of private plan pension is known as Hybrid or Mixed, it takes into consideration the amount of contributions made in the name of each employee, as well as the amount that the company defines as the remuneration the employee will receive.

Restrictions

9 | What restrictions or prohibitions limit an employer's ability to exclude certain employees from participation in broad-based retirement plans?

If the employer wants to keep all the tax benefits given for applying a private pension plan, it must offer the plan to all its employees of two main classes, unionised or non-unionised. However, the employer can define general rules or conditions such as the amount of the contributions made by each employee or seniority in employment.

10 | Can plans require employees to work for a specified period to participate in the plan or become vested in benefits they have accrued?

Yes, in certain plans the employer can impose certain conditions, such as the employee's seniority in his or her job, or in the case of an early retirement, that the employee must not withdraw the entire amount, but only the part determined by the employer. Parties can freely agree to the rules of the plan, but the only amounts that will always be respected or returned to the employee are those that are invested with the employee's own contributions.

Overseas employees

11 | What are the considerations regarding employees working permanently and temporarily overseas? Are they eligible to join or remain in a plan regulated in your jurisdiction?

Given that the employer sets the terms and conditions of the private pension plan, employees who work permanently or temporarily overseas may participate. This could eventually cause some tax problems, as the benefits of the plan are not derived from the direct employment relationship and, therefore, it could be considered as taxable income.

Funding

12 | Do employer and employees share in the financing of the benefits and are the benefits funded in a trust or other secure vehicle?

This depends on the type of plan. In a defined benefit plan the company assumes the cost of the plan, including the risks of investment. In a defined contribution plan the benefits for the employees will be the difference between the sum of the contributions and the diminished profits of the losses and the expenses of administration of the fund.

These plans are usually administered through trusts or open contracts in investment fund operators or brokerage firms. Usually they invest in public debt or variable national income.

13 | What rules apply to the level at which benefits are funded and what is the process for an employer to determine how much to fund a defined benefit pension plan annually?

The rules according to the plans as follows:

- Defined contribution. The company delivers pre-established amounts or percentages to a determined investment fund, the benefits for the employees will be the difference between the sum of the contributions and the diminished profits of the losses and the administration expenses of the fund. The benefits depend on the

accumulated balance in the individual account of each worker and can provide both pre-established amounts or percentages.

- Defined benefit. The responsibility of the company ends with the liquidation of the benefits, and the retirement amounts are determined based on a structure established in the private pension plan. The investment risks and the cost of the plan are assumed by the company. The benefits are based on salary or years of service.
- Hybrids or mixed. These are a combination of variables of the two previous types. The company is not limited by a legally contracted amount, but can make additional contributions if the assets are insufficient to cover its obligations. The benefits depend on the accumulated balance in each worker's individual account and have a minimum retirement benefit guarantee.

Level of benefits

14 | What are customary levels of benefits provided to employees participating in private plans?

Benefits from contributed amounts are amounts not considered as taxable income. There are other private pension plans that allow for voluntary contributions.

Pension escalation

15 | Are there statutory provisions for the increase of pensions in payment and the revaluation of deferred pensions?

No.

Death benefits

16 | What pre-retirement death benefits are customarily provided to employees' beneficiaries and are there any mandatory rules with respect to death benefits?

There are no pre-retirement benefits provided by law.

Mandatory pensions and benefits commonly comprise:

- funeral expenses;
- money pension plans for widows and orphans, with the following exceptions:
 - if the insured dies before turning six months of marriage;
 - if the insured is 55 years old or older and has not been married one year;
 - if at the time of marriage the insured had an old age retirement pension, unless they had a year of marriage; and
- a Christmas bonus of 15 days of salary, in relation to the amount of pension received.

Beneficiaries of employees or voluntarily insured people must comply with several rules depending on the pension structure, the cause of death, and amount of social weekly contributions recognised by the Social Security Mexican Institute.

The most commonly requirements are described as follows:

- a recognition of payment by the Social Security Mexican Institute of at least 150 weekly contributions of the deceased;
- pensioned owing to a disability;
- evidence of a relationship with the deceased; and
- that the death was not owing to a work-related accident.

Mandatory rules also determined that the beneficiaries have to choose an insurance company to arrange the pension guidelines considering the contributions accrued by the deceased.

Retirement

- 17 | When can employees retire and receive their full plan benefits? How does early retirement affect benefit calculations?

For public pensions once the employee turns 60 (early retirement) through 65 (full retirement) years old, his or her registration with the Mexican Social Security Institute is cancelled, with a minimum payment of 1,250 weekly recognised contributions. This is applicable to those who started their employment relationship after 1997. For those who started before, the age is the same, but the weekly amount is 500 weekly recognised contributions.

Usually, plan benefits are given to the employees once they have retired or at the moment of their employment termination.

Early retirement affects benefit calculations as regards tax treatment, by law. If the contributions are withdrawn before the agreed term of the private plan, its tax burden will increase.

Early distribution and loans

- 18 | Are plans permitted to allow distributions or loans of all or some of the plan benefits to members that are still employed?

There are some private plans that allow loan or distributions of the plan benefits, but it is not common given that such withdrawals may affect the deductibility of the benefit.

Change of employer or pension scheme

- 19 | Is the sufficiency of retirement benefits affected greatly if employees change employer while they are accruing benefits?

Private plans are for all employees, considering that this is a requirement for its deductibility.

Therefore, if an employee changes his or her employer, he or she would have the following options:

- transfer his or her benefits to his public retirement savings (AFORE);
- hire a private pension individual plan and continue with his or her voluntarily contributions; and
- in case the new employer has a private pension plan with the same financial institution, then his benefits can be transferred to the new pension plan. However, this would be determined by the private pension plan.

With respect to the mandatory retirement plan, the change of employer does not affect.

- 20 | In what circumstances may members transfer their benefits to another pension scheme?

If the private plan establishes the possibility, then employee can transfer. However, he or she would have to consider that a tax burden can be imposed on his or her benefits, and will have to comply with the requirements of the new pension scheme. It is not customary in Mexico to change funds from one benefit plan to another. Commonly, employees lose the right upon termination of employment.

Investment management

- 21 | Who is responsible for the investment of plan funds and the sufficiency of investment returns?

Financial institutions registered under the CONSAR (National Savings System for Retirement Commission), considered as funds administrators.

Such financial institutions enter into agreements with the employers to execute a collective private pension plan in favour of their employees.

Reduction in force

- 22 | Can plan benefits be enhanced for certain groups of employees in connection with a voluntary or involuntary reduction in workforce programme?

No.

Executive-only plans

- 23 | Are non-broad based (eg, executive-only) plans permitted and what types of benefits do they typically provide?

Mexican law recognises the same benefits and prerogatives for union and non-union employees and, therefore, retirement plans will generally have the same terms and conditions for every participant. While some plans may be restricted for non-union employees, if the plan allows the participation of any employee, it will not establish different requirements for access to retirement benefits.

- 24 | How do the legal requirements for non-broad based plans differ from the requirements that apply to broad-based plans?

The CONSAR has the authority to review the requirements established for the registration of private retirement plans, according to the regulations applicable to these. Once registered, the plans will only be subject to the review of the CONSAR in case of a change to their terms and conditions of employment that should also be filed and registered with the CONSAR.

Unionised employees

- 25 | How do retirement benefits provided to employees in a trade union differ from those provided to non-unionised employees?

Employers that fail to comply with applicable Mexican legislation with respect to their private retirement plans will not be allowed to take the deductibility of the contributions made to plan.

- 26 | How do the legal requirements for trade-union-sponsored arrangements differ from the requirements that apply to other broad-based arrangements?

Mexican law recognises the same benefits and prerogatives for union and non-union employees and, therefore, retirement plans will generally have the same terms and conditions for every participant. While some plans may be restricted for non-union employees, if the plan allows the participation of any employee, it will not establish different requirements to have access to retirement benefits.

ENFORCEMENT

Examination for compliance

- 27 | What is the process for plan regulators to examine a plan for periodic legal compliance?

The CONSAR has the authority to review the requirements established for the registration of private retirement plans, according to the regulations applicable to the same. Once registered, the plans will only be subject to the review of the CONSAR in case of a change to their terms and conditions of employment that should also be filed and registered with the CONSAR.

Penalties

28 | What sanctions will employers face if plans are not legally compliant?

Employers that fail to comply with applicable Mexican legislation with respect to their private retirement plans will not be allowed to take the deductibility of the contributions made to plan.

Rectification

29 | How can employers correct errors in plan documentation or administration in advance of a review by governing agencies?

As a requirement to obtain registration of private retirement plans before the CONSAR, employers must also attach an actuarial analysis by an authorised professional, to identify the obligations and costs associated with the operation and funding of the plan. Employers may correct errors by updating the actuarial analysis and conducting periodical reviews of the plan's content by tax and compensation experts.

Disclosure obligations

30 | What disclosures must be provided to the authorities in connection with plan administration?

The plan administrator of a private pension plan is a technical committee, normally comprised of current employees of the employer. Appointing individuals from the finance and human resources department to the technical committee is a common practice. Authorities are informed from time to time the names and term of the members holding a position in the Technical Committee.

31 | What disclosures must be provided to plan participants?

Although not required by law, it is considered a 'best practice' that participants are made aware of the all terms and conditions of the plan, except for the financial balance or actuarial analysis corresponding to its funding.

Enforcement mechanisms

32 | What means are available to plan participants to enforce their rights under pension and retirement plans?

Private pension and retirement plans are unilaterally established by employers. However, at the time the plan is in place and a participant has vested rights under the same, retirement benefits become part of the employee's terms and conditions of employment. Accordingly, a participant with vested rights in a pension or retirement plan has the right to bring an action against the employer before the Conciliation and Arbitration Board in Mexico, to enforce those rights.

PLAN CHANGES AND TERMINATION

Rules and restrictions

33 | What restrictions and requirements exist with respect to an employer's changing the terms of a plan?

In general terms, changes to a private pension or retirement plan cannot have a negative impact to the vested or acquired rights of the participant. The technical committee as the plan administrator can approve changes that will not reduce or eliminate the participants' rights under the plan.

34 | What restrictions and requirements exist with respect to an employer terminating a plan?

The employer can terminate a private pension plan, provided contributions by participants are reimbursed along with accrued interests. Similarly, if a participant already has a vested right under the plan, the employer is responsible for paying to or allowing the participant to enjoy such right prior to termination.

Insolvency protection

35 | What protections are in place for plan benefits in the event of employer insolvency?

Employee rights are pre-eminent over any other creditor and therefore, an employee with vested rights under a pension or retirement plan will be entitled to claim the corresponding benefits before other company debts. Mexican labour law provides that employees do not need to participate in an insolvency procedure to claim the payment of mandatory labour and employment benefits.

Business transfer

36 | How are retirement benefits affected if the employer is acquired?

In a share acquisition, a private pension plan will continue its operation without any impact. The employer sponsoring the plan will continue it and the change of share ownership, normally, does not trigger any change to the terms and conditions of the plan. In an asset acquisition, the standard practice is that the buyer sets up a pension plan with similar terms and conditions. This will allow the employees who will also transfer to the buyer to continue participating in the plan. The funds of the plan in this latter scenario would normally transfer to the buyer's new pension plan to honour the contributions made by the employer or the participants. Provided the transfer of the funds will have the same purpose of guaranteeing pension or retirement rights, there would not be a tax effect associated with the transfer of financial resources.

Surplus

37 | Upon plan termination, how can any surplus amounts be utilised?

Once the plan administrator has reimbursed participants for all their contributions and accrued interests, and has paid out any pension or retirement benefit to participants satisfying the requirements of the plan, the employer can take control of the remaining balance.

FIDUCIARY RESPONSIBILITIES

Applicable fiduciaries

38 | Which persons and entities are 'fiduciaries'?

Mexican rules applying to private pension plans provide that financial institutions, credit agencies, stockbrokers, investment firms and retirement fund administrators can act as fiduciaries of the retirement plan.

Fiduciary duties

39 | What duties apply to fiduciaries?

The fiduciaries will normally enter into a financial services agreement with the employer sponsoring the plan and will assume the obligations of administering the funds, invest the contributions made to the same under the restrictions established in the law, and, whenever necessary, process the reimbursement of contributions and interests

(ie, termination of participation in the plan), and payment of retirement benefits (ie, satisfying eligibility requirements).

Breach of duties

- 40 | What are the consequences of fiduciaries' failing to discharge their duties?

Failing to comply with its fiduciary duties could be sufficient grounds to terminate the services agreement with the fiduciary and claim civil damages.

LEGAL DEVELOPMENTS AND TRENDS

Legal challenges

- 41 | Have there been legal challenges when certain types of plans are converted to different ones?

No.

- 42 | Have there been legal challenges to other aspects of plan design and administration?

No.

Future prospects

- 43 | How will funding shortfalls, changing worker demographics and future legislation likely affect private pensions in the future?

The legal requirement of having an actuarial analysis would balance all these factors. The actuarial analysis includes forecasts of funding depending on the number of participants, their seniority and age. It also considers the company's trend for hiring and terminating of employees, which will affect the periodic contributions with which the employer must comply.



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