Recent developments in the Mexican pension system and challenges ahead

15 de Noviembre, 2017

Carlos Ramírez Fuentes
Presidente de la CONSAR
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II. Recent evolution of Mexico’s Pension System

III. How can pension funds invest in infrastructure

IV. Opportunities ahead

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VI. Conclusions
Dependency rate (Mexico and Europe)
(population 0-19 and 65+/population 20-64)

The pensions system was reformed in 1997 for private workers and in 2007 for public service workers transforming the traditional defined benefit (DB) system into a mandatory defined contribution (DC).

The system is mandatory for all private and federal government workers.

Workers contribute 6.5% of their monthly salary to their pension fund (private sector workers).

The National Commission for the Retirement Savings System (CONSAR) regulates and supervises the Pension Fund Administrators (AFORE).
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Pension Funds’ assets under management represents 15.10% of the GDP.
# Evolution of Pension Funds Investment Framework

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2/ Only USD, Euros & Yens until 2010. All other currencies were allowed from 2010.
3/ When launched this investment vehicle was a capital protected note
4/ The first FIBRA was issued until 03/2011, though.
5/ The prior financial and legal structure of the current SPV was issued on 08/2008.
As a consequence, portfolio diversification has improved although much remains to be done.
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CKDs and CERPIs are very flexible investment vehicles

CKDs/CERPIs can be used to finance:
- Different stages of the development of a real project
- Any economic sector or activity
- And financial structures can be adjusted

The projects must be developed in Mexico
INVESTMENTS IN CKD’S BY SECTOR

Through the investment of CKDs, AFOREs have financed a growing range of projects and firms

<table>
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<tr>
<th>Type of CKD</th>
<th>As a % of investment by AFOREs</th>
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<tr>
<td>Infrastructure (Including Energy)</td>
<td>34.3%</td>
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<tr>
<td>Real Estate</td>
<td>27.3%</td>
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<tr>
<td>Capital</td>
<td>25.2%</td>
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<tr>
<td>Financial Services</td>
<td>11.43%</td>
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<tr>
<td>Forestry</td>
<td>1.82%</td>
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</table>
AFOREs finance 87% of total CKDs/CERPI (147 billion pesos) and 36% of FIBRAs (58 billion pesos)

Evolution of CKDs and FIBRAs

Positions of AFOREs

(millions of pesos)

TOTAL: 205,027 MXN million
CONSAR regulation has *pushed* pension funds’ to focus on increasing their internal capacities:

- Improvement of *due-diligence* for the selection of manager
- Increase *human capital*
- Better use of *technology*: risk system
- Deepen the understanding of the *non-financial risks*: legal, technological, political, operational, social, environmental, etc.
- More regulatory space to invest in equity, Reits, and alternatives
- Less restrictive investment limits on alternatives (CKDs and CERPIs): pension funds may now acquire the total amount of the issuance, regardless of its size.
- New prudential measures for CKDs and CERPIs: more responsibility to the Board. AFORE may now set their own prudential limits regarding concentration limits in a project, GP and issuance as well as eligibility policies on co-investors.
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STRUCTURAL REFORMS ARE OPENING UP NEW AND MAJOR INVESTMENT OPPORTUNITIES FOR AFOREs

Structural reforms:

1. Telecommunications
2. Competition
3. Financial sector
4. Energy

New business opportunities will open up in several sectors

Pension funds will continue to play a fundamental role in financing long term projects

Fuente: CONSAR
It is expected that total AUM of AFOREs will continue to grow* at a significant pace.

Assets under management by AFOREs (billions of pesos)

*Projections are solely used for the presentation purposes and should only be used as a guidance.
Mexican pension funds urgently need more diversification

Notes: All data are expressed in percent of total investment. See the end of this factsheet for more methodological notes and country-specific details.

Source: OECD Global Pension Statistics; Australian Bureau of Statistics; Bank of Japan.

OPPORTUNITIES AHEAD

• Where will future returns come from?

Historic real returns of Mexico’s pension system (2003-2017)
OPPORTUNITIES AHEAD

Favorable environment to boost long term investments:

- Growth of assets under management by SIEFOREs
- New investment opportunities and new government with infrastructure needs
- An environment of lower returns and needs for major diversifications

Favorable moment to boost long term investments
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CHALLENGES FOR PENSION FUNDS
LONG TERM INVESTMENTS

- Challenges for long term investment projects in the Mexican Pension System

### Demand-side obstacles

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<th>Demand constraints</th>
<th>Supply-side obstacles</th>
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<tr>
<td>1. Short term focus: commercial bias</td>
<td>1. Depth of Mexican financial markets</td>
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<tr>
<td>2. Analytical capabilities of AFOREs // insufficient competition</td>
<td>2. Scarcity of good projects and managers</td>
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<tr>
<td>3. Legal restrictions // pension funds have to invest through public offerings</td>
<td>3. Political/social/ legal risks</td>
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Nonetheless, key structural challenges remain:

- Low level of mandatory savings
- Increase coverage
- More flexibility to invest
- Link pillars
- More competition: returns and fees
- Increasing cost of DB systems
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CONCLUSIONS

• Mexico’s current conditions offer significant opportunities for the AFOREs to participate actively as Mexico’s main institutional investors in long term projects.

• Recent regulatory changes by CONSAR to the pension system seek to:
  o More flexibility for active pension funds
  o Offer more opportunities for diversification
  o Strengthen the industry’s human capital
  o Expand investment horizons of the AFOREs industry
  o Strengthen AFOREs’ corporate governance

• It is imperative to continue with the development of internal capabilities in the pension fund industry

• Mexico urgently needs another pension reform: opportunity and challenge for new government
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