



RECENT DEVELOPMENTS IN THE MEXICAN PENSION SYSTEM AND CHALLENGES AHEAD

15 DE NOVIEMBRE, 2017



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Presidente de la CONSAR

I. Introduction

II. Recent evolution of Mexico's Pension System

III. How can pension funds invest in infrastructure

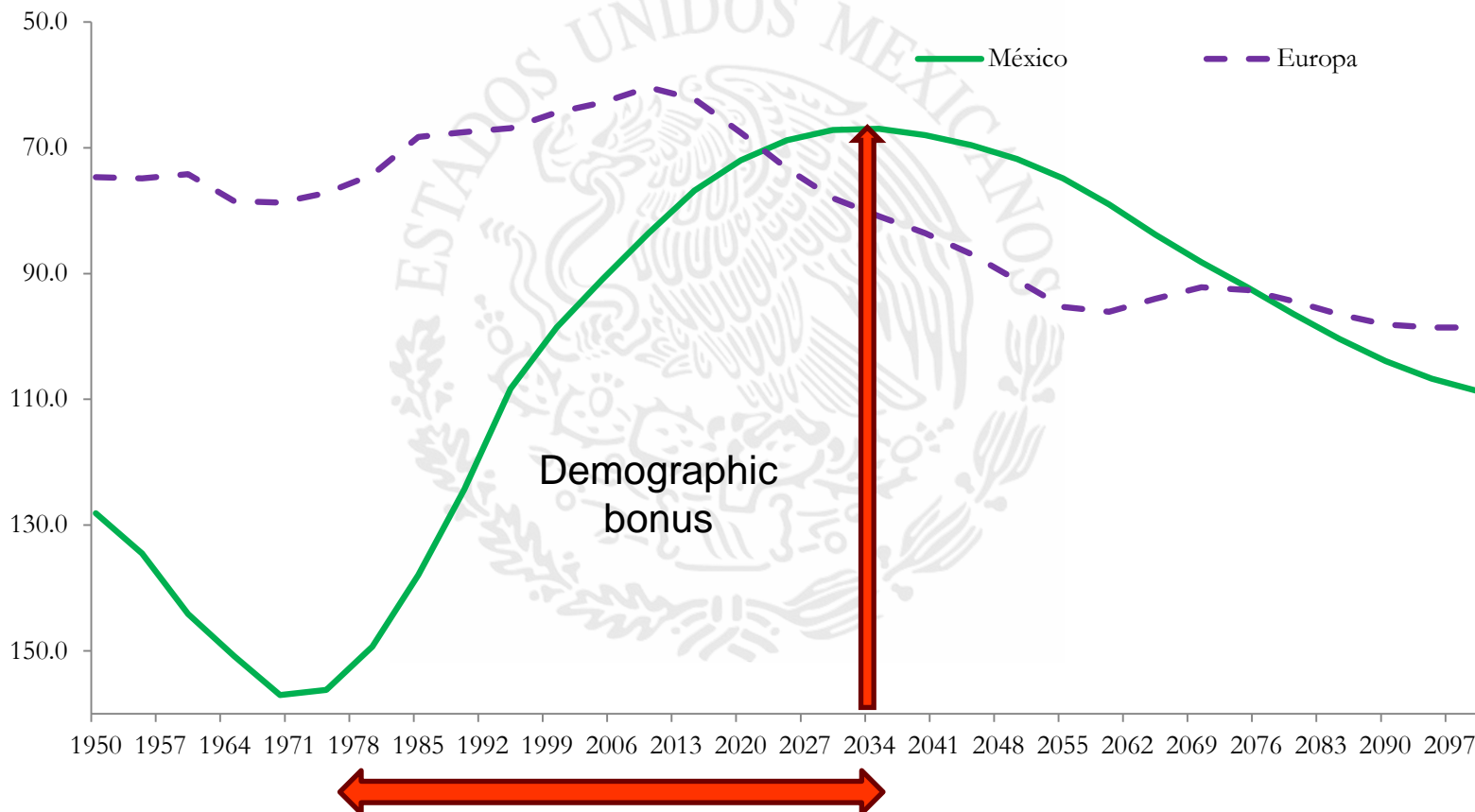
IV. Opportunities ahead

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MEXICO'S DEMOGRAPHY WILL CHANGE DRAMATICALLY

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



Fuente: United Nations, Department of Economic and Social Affairs, Population Division (2015). World Population Prospects: The 2015 Revision,

MEXICO PENSION REFORMS

- 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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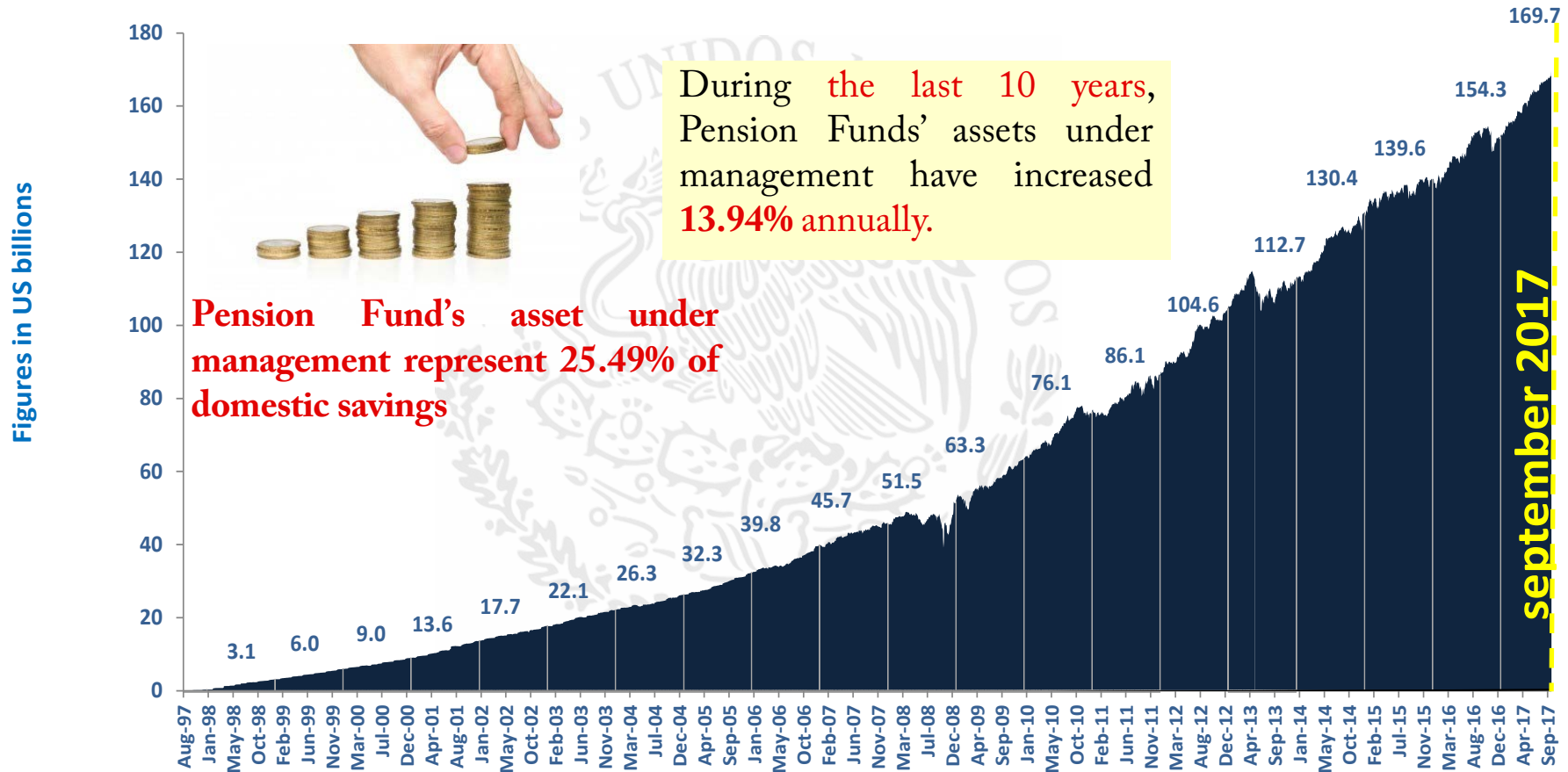
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PENSION FUNDS' ASSETS UNDER MANAGEMENT

US \$169.7 BILLION.

Mexican Pension Funds' assets under management



Figures in US billion. Currency exchange constant. Data as of september 2017.

Source: CON SAR.

Pension Funds' assets under management represents 15.10% of the GDP

EVOLUTION OF PENSION FUNDS INVESTMENT FRAMEWORK

Asset Class		1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Debt ^{1/}		✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Currencies ^{2/}		✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Listed Equity ^{3/}		x	x	x	x	x	x	x	x	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Securitisations (ABS)		x	x	x	x	x	x	x	x	x	x	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Commodities		x	x	x	x	x	x	x	x	x	x	x	x	x	x	✓	✓	✓	✓	✓	✓
REITs		x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	✓	✓	✓	✓
Hedging tools		x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	✓	✓	✓	✓
FIBRAs	FIBRA Generic ^{4/}	x	x	x	x	x	x	x	x	x	x	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
	FIBRA E	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	✓
SPV	CKDs ^{5/}	x	x	x	x	x	x	x	x	x	x	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
	CERPIs	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	✓

1/ Foreign Debt from 2005. Subordinated Debt from 2009. Structured Debt & lower than investment grade debt (local scale) from 2010. Debt with exposure to and guarantee by real assets and rights from 2013.

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

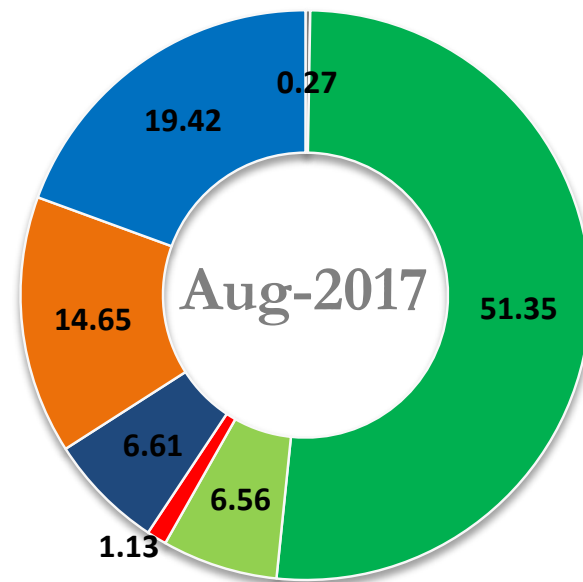
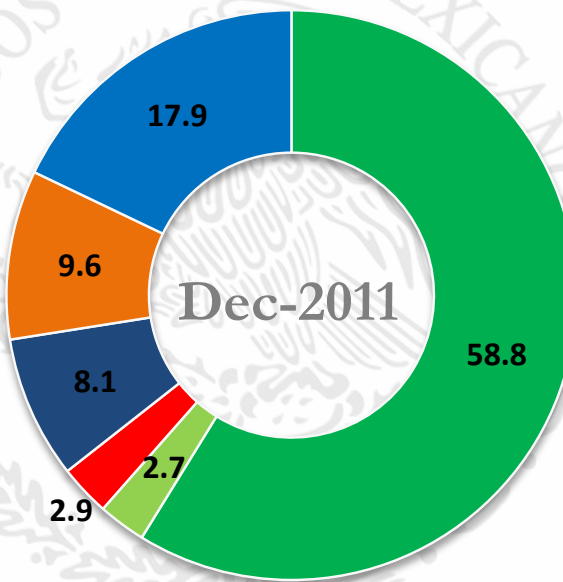
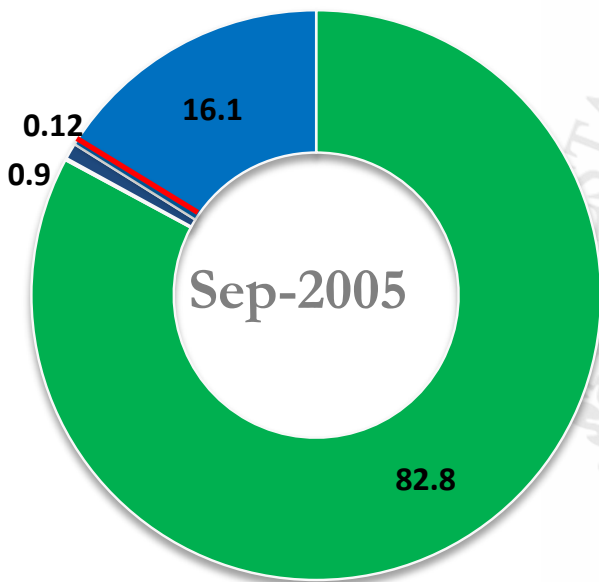
4/ The first FIBRA was issued until 03/2011, though.

5/ The prior financial and legal structure of the current SPV was issued on 08/2008.

PORTFOLIO DIVERSIFICATION

As a consequence, **portfolio diversification** has improved although much remains to be done

Portfolios of SIEFOREs
(%)



Commodities

International Bonds

Local Bonds

Government Securities

Equity (Domestic)

Alternative Investments

Equity (International)

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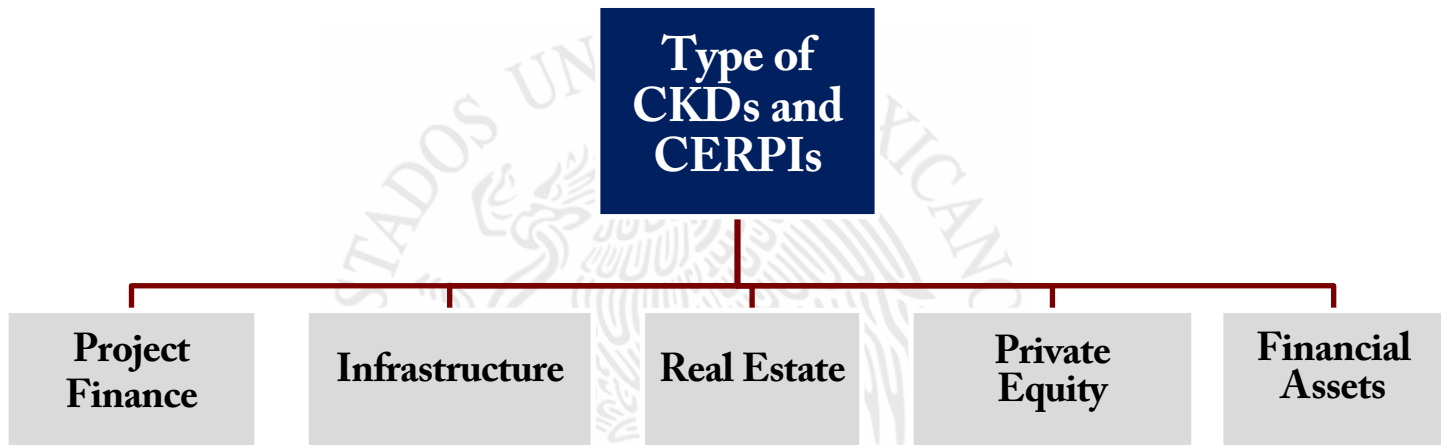
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HOW CAN MEXICAN PENSION FUNDS INVEST IN REAL ASSETS

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

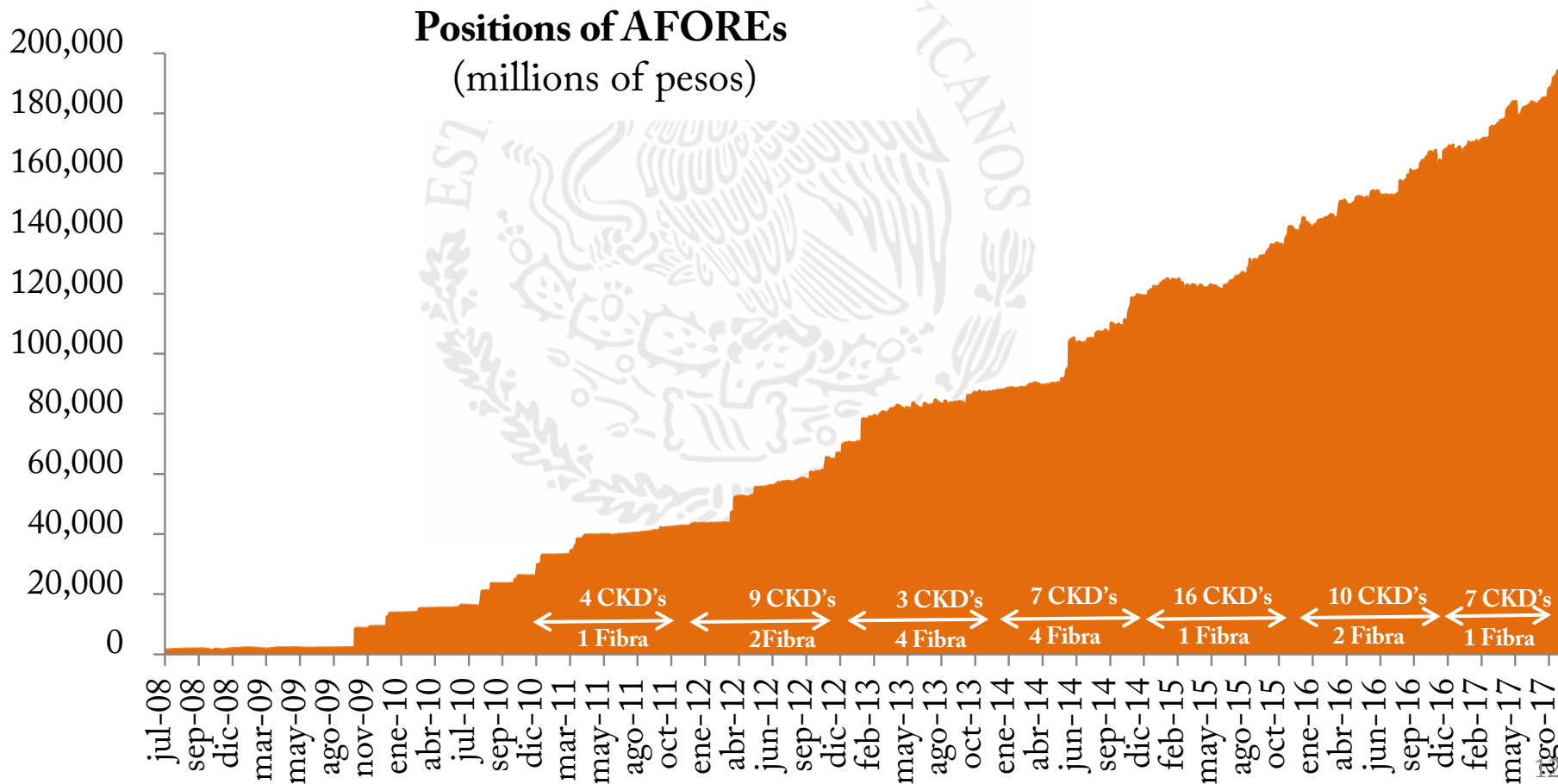
	Type of CKD	As a % of investment by AFOREs
	Infrastructure (Including Energy)	34.3%
	Real Estate	27.3%
	Capital	25.2%
	Financial Services	11.43%
	Forestry	1.82%

ALTERNATIVE INVESTMENTS BY AFORES

AFOREs finance 87% of total CKD's/CERPI (147 billion pesos) and 36% of FIBRA's (58 billion pesos)

Evolution of CKDs and FIBRA's

TOTAL: 205,027 MXN million



RECENT REGULATORY CHANGES

- CONSAR regulation has *pushed* pension funds' to **focus** on increasing their internal capacities:
 - Improvement of **due-dilligence** 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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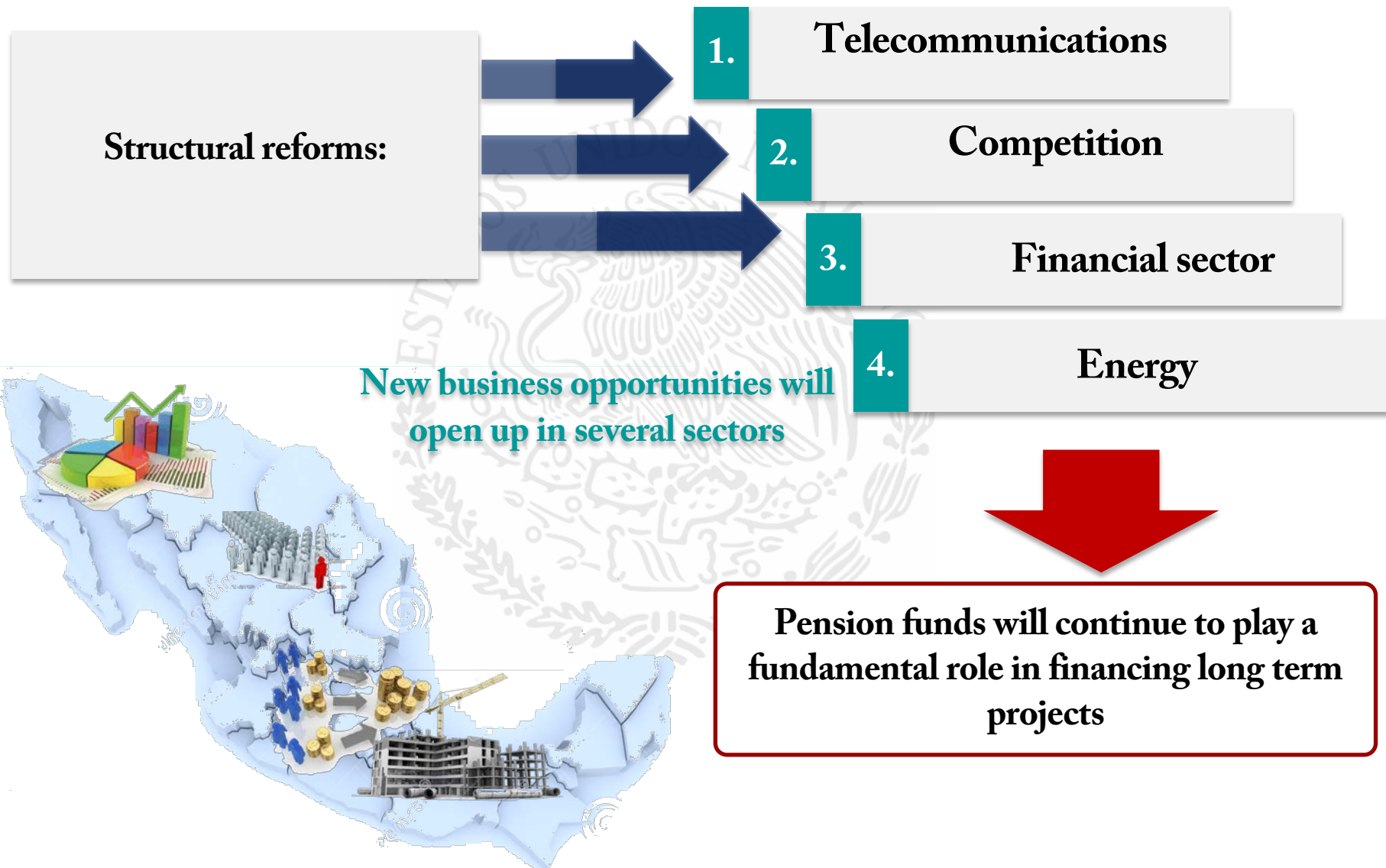
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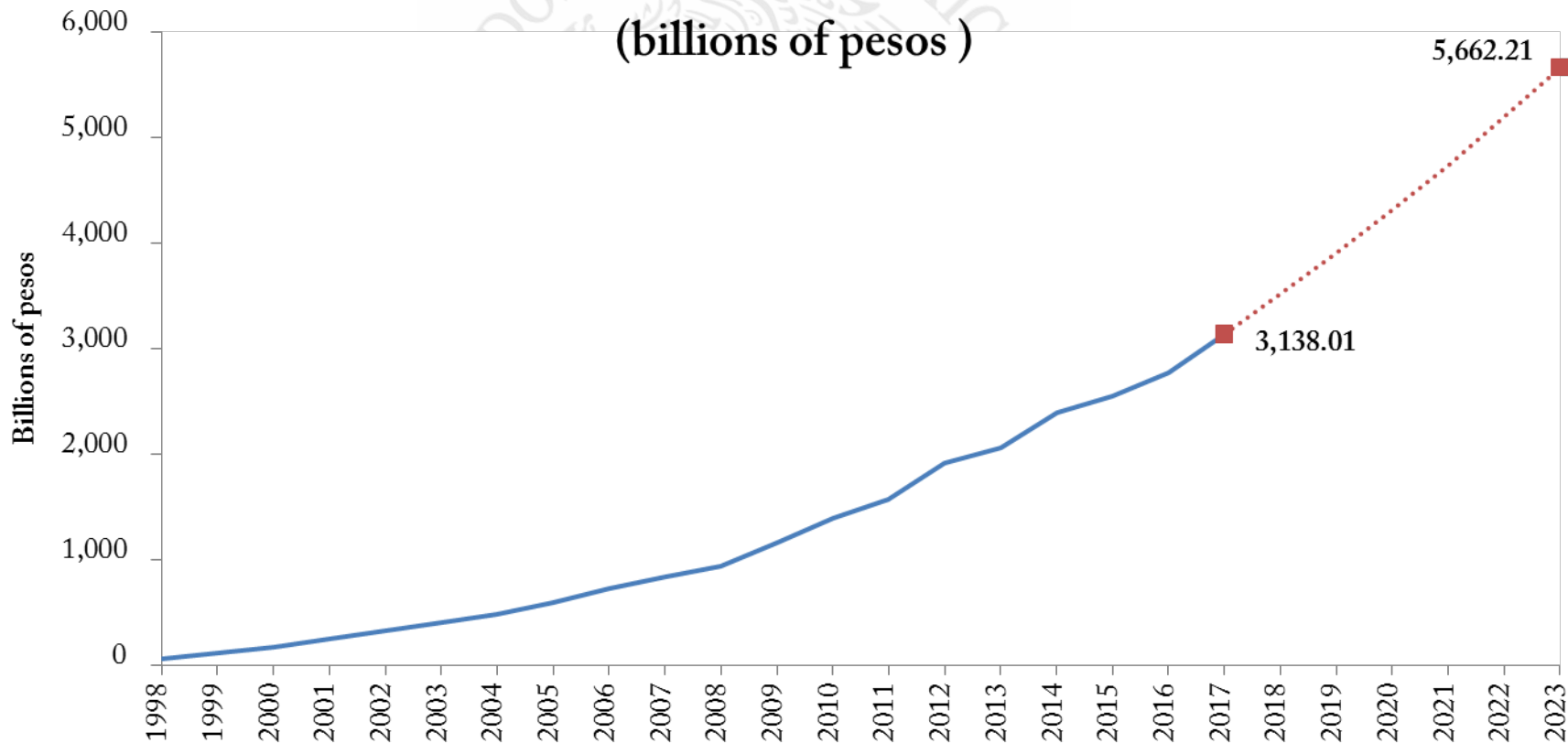
STRUCTURAL REFORMS ARE OPENING UP NEW AND MAJOR INVESTMENT OPPORTUNITIES FOR AFORES



OPPORTUNITIES AHEAD

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

Assets under management by AFOREs
(billions of pesos)

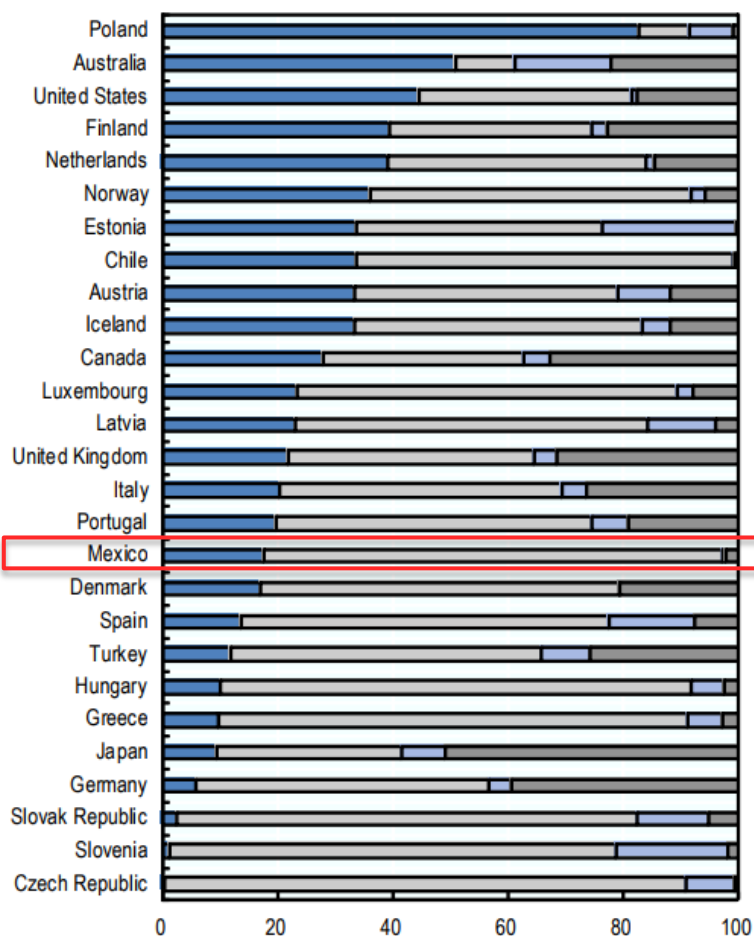


*Projections are solely used for the presentation purposes and should only be used as a guidance

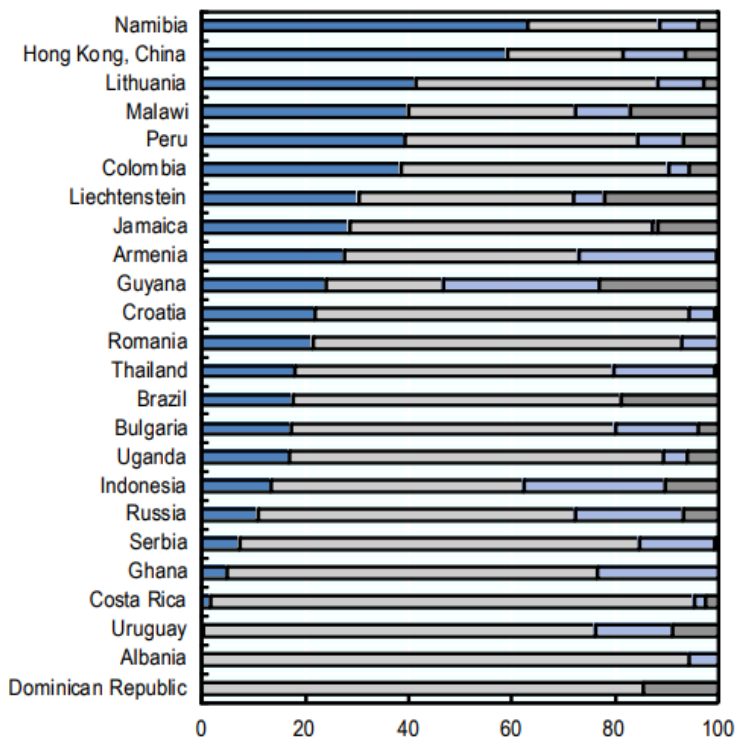
Mexican pension funds urgently need more diversification

Equities Bills and bonds Cash and Deposits Other

A. Selected OECD economies



B. Selected non-OECD economies

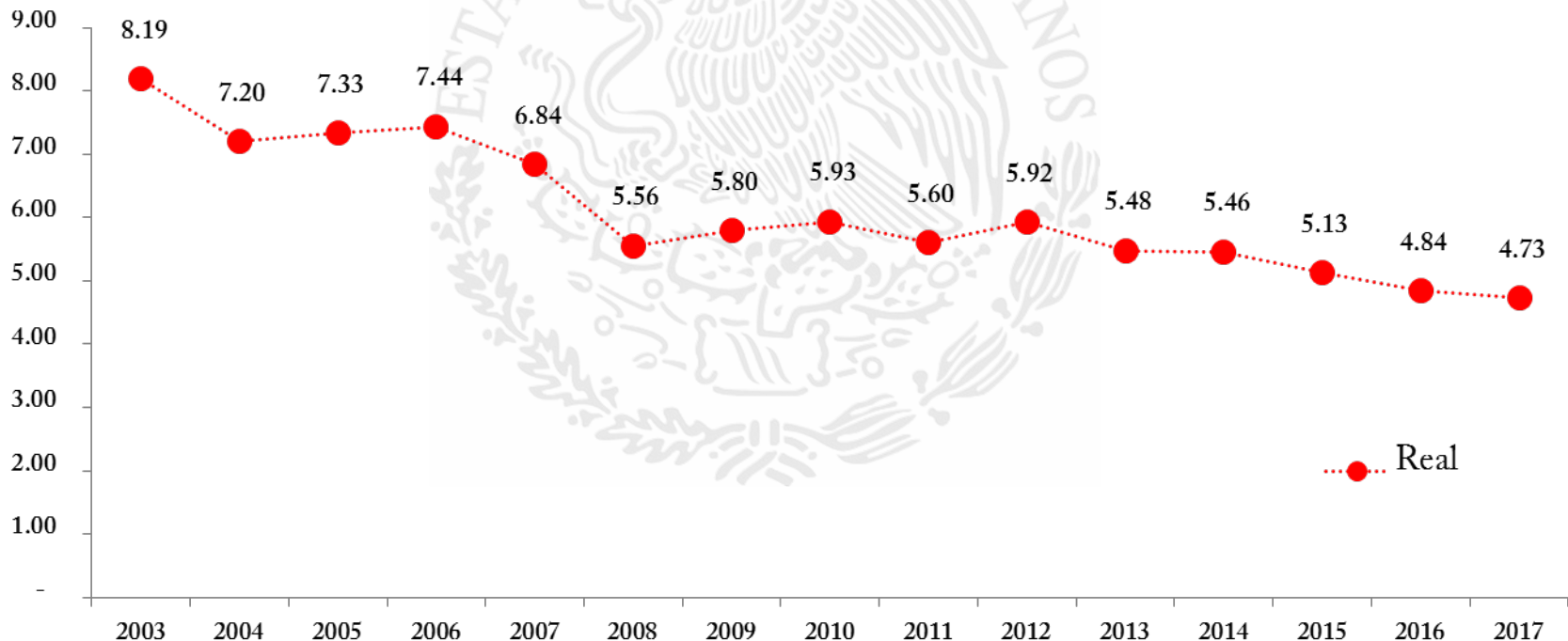


Notes: All data are expressed in percent of total investment. See the end of this factsheet for more methodological notes and country-specific details.

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

- ¿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

Supply-side obstacles

Demand constraints	Supply constraints
1. Short term focus: commercial bias	1. Depth of Mexican financial markets
2. Analytical capabilities of AFOREs // insufficient competition	2. Scarcity of good projects and managers
3. Legal restrictions // pension funds have to invest through public offerings	3. Political/social/ legal risks

STRUCTURAL CHALLENGES AHEAD

➤ 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:
 - More flexibility for active pension funds
 - Offer more opportunities for diversification
 - Strengthen the industry's human capital
 - Expand investment horizons of the AFOREs industry
 - 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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