Re: The Guide to Latin America Pension Funds and related services

We are focusing our research and consulting talents on an exciting area in emerging markets investment opportunities – the funded pension plans of Latin America, and their asset managers.

In this note, we'd like to outline the opportunities that might exist for Managers in this sector and how ***The Guide to Latin America Pension Funds*** and our consulting services can help Managers.

How ***The Guide*** can help Managers' investment strategy in Latin America:

1. Local pension funds represent natural co-investors for MANAGERS investment in the region's investment opportunities in international equities, private equity, in infrastructure projects, and in alternative asset classes such as commodities and real estate. ***The Guide, which is a historic data base,*** makes identifying who are the biggest players in 23 asset categories in each of the 11 economies easy to do, and subscribers to our update services are kept ahead of the latest changes and trends.

2. The asset management companies specializing in providing investment and administrative services to the region's pension funds (DB and DC) represent potential equity investment opportunities for MANAGERS as part of its investment strategy to tap the growth of consumer-oriented companies, particularly in the financial services sectors. Again, ***the Guide*** and its subscriber services makes it easy to see who the biggest and/or fast-growing players are, and how things may be changing.

Campollo Consulting and WSAS can add custom research and consulting services to suit MANAGERS's interests in the region and sector – for instance, research on past and prospective pension fund investments on a country or sector basis, or on the shareholders of pension asset management companies across the region, for potential strategic allies or buy-out candidates.

Why might MANAGERS be interested in Latin America's Pension Funds Industry?

Latin America has been one of the few bright spots in the global economy in the past decade. Real economic growth for the region as a whole averaged almost 3.5% per annum, with many of its major economies posting even better gains. And, IMF projections for the region as a whole are for it to grow nearly twice as fast the advanced economies over the next 5 years.

One widely-cited contributory factor for the region's economic growth is its pension funds. The adoption in the 1990s and 2000s of mandatory-participation, individually-capitalized pension fund accounts collectively managed and administered by specialized companies has been vital to this economic success.

Today, such pension funds have over US$ 690 billion in assets, and assets under management are widely forecast to grow at 15%+ per annum over the next few years.

Growth in pension assets is underpinned by 2 secular trends. One is demographics favorable to asset accumulation. The working-age population, the contributory base for pension asset accumulation, is projected by the World Bank to grow from about 380 million people (65% of the population) to almost 473 million people (67% of the population) by 2035.

The second secular trend is for these economies to have increasingly urbanized and formalized economies, meaning that increasing proportions of the growing workforces will be contributing to pension fund accounts.

Combined, these trends promise attractive business opportunities for asset management companies and related services providers.

Trends in the Evolution of Latin America's Pension Funds

There are a number of key trends in the recent evolution of Latin America's pension funds that clients of ***The Guide*** will note:

1) The high rate of growth of assets under management;
2) The increasing degree of investment diversification permitted, including overseas assets;
3) The introduction of funds targeted to age groups and/or risk preferences;
4) The entrance and exit of asset management companies and changes in individual shareholders; and
5) 'counter-trends' – countries which have turned away from the capitalized individual account, private sector managed model.

The Growth of Pension Fund Assets

Over the past 4 years, many of the Latin American pension fund markets reached considerable assets' size. As the table below shows, three markets had accumulated assets in excess of $100 billion by the end of 2010 (2011 figures are due shortly).

Overall, assets in US$ terms grew by 43% over the three-year period ending in 2010, with some markets (Dominican Republic, Colombia, Bolivia, & Costa Rica) demonstrating triple-digit or near triple-digit growth.

Pension Fund Assets, by Country

Total Assets US$ mn.	**Dec 2007**	**Dec 2008**	**Dec 2009**	**Dec 2010**
Brazil	230,243	173,416	274,661	314,772
Chile	112,503	76,819	121,473	152,274
Mexico	76,287	68,586	87,720	111,088
Colombia	29,793	30,522	44,712	57,490
Peru	20,566	15,927	23,942	31,148
Uruguay	3,470	2,946	5,296	6,731
El Salvador	4,080	4,562	5,157	5,725

Bolivia	2,967	3,948	4,633	5,474
Costa Rica	1,696	1,786	2,428	3,275
Dominican Rep	1,344	1,745	2,354	2,904
Panama	70	661	792	845
Grand Total	**483,019**	**380,920**	**573,169**	**691,726**

Yet despite the rapid growth rates of assets under management, most of the markets have considerable room for growth. For instance, a common proxy for market penetration is the "pension assets to GDP" ratio. For 2010, the simple average among all OECD countries at the end of 2010 was 33%, but among Latin America's markets only Chile was above that point (for scale, the Netherland was world leader at 135%, with the UK at 87% and the US at 73%).

The table shows the results by market; note that the major markets of Brazil, Mexico, Colombia and Peru still have quite a bit of room for expansion, using this measure.

Market	Assets Ratio to GDP, 2010
Chile	74.9%
Bolivia	27.6%
El Salvador	26.3%
Peru	20.2%
Colombia	19.9%
Uruguay	16.7%
Brazil	15.1%
Mexico	10.7%
Costa Rica	9.5%
Dominican Rep	5.6%
Panama	3.2%
Weighted Av.	17.4%
Simple Av.	20.9%

The Increasing Diversification of Pension Funds' Assets

It's a feature of Latin America's pension funds' investments that they have been constrained by national regulations as to the asset types in which they could invest and their exposure limits to those assets, and that the limits are gradually expanded over time to allow more diversification and management discretion.

The reasons for this are mixed - there is a natural inclination to restrict investment to high-quality domestic assets such as government bonds and highly-rated fixed income securities for prudential reasons regarding credit and foreign exchange risk, and to support the expansion of the domestic capital markets.

Once the funds had achieved some scale and operating experience, they are allowed to purchase domestic listed equities and mutual funds, for their diversification benefit, returns potential, and the domestic capital market development contributions.

Thereafter, as the pension funds continue to expand their assets through affiliates' contributions, to demonstrate their operational capacity, and start to 'crowd' their domestic assets markets, authorities widen eligible domestic asset classes to include private equity, venture capital, real estate (residential and commercial), commodities, and derivative products.

Finally, assuming national foreign exchange positions permit, foreign assets are made eligible investments, with again a preference or progression given to high-quality credit instruments and to listed equities.

Note should be taken that having the right to invest in assets classes, particularly foreign assets, doesn't mean that pension funds have invested to their limits. Yields on Brazil's domestic credit instruments have been very attractive vis-à-vis those on foreign instruments, for example, and below-foreign limit exposures to foreign assets before and since the 2008 global financial meltdown helped to preserve pensions' asset values across the region.

The introduction of funds targeted to age groups and/or risk preferences (the multifondos concept)
As pension assets under management grew in Chile, the regulators recognized that it was appropriate to segment the funds' affiliates, their assets, and eligible asset classes into a series of funds distinguished by the degree of risk allowed in the portfolio (in Spanish, multifondos), from a 'one fund fits all' concept.

In Chile, this led in 2000 to establishment of a second fund under each AFP for workers within 10 years of retirement age, and in 2002, to the establishment by each AFP of 5 risk-based funds, along the lines of 'life-cycle' families of funds, ranging from the most risk-tolerant funds (called A funds) to the most conservative funds (E funds), for affiliates who were very risk-adverse or who had started to draw on their retirement accounts.

The Entrance and Exit of Asset Administrators and Changes in Their Shareholders
The administration of pension accounts and their asset management can be quite profitable once the funds under management reach a critical mass, but competition can be fierce, marketing costs high, and consequently the region has a history of mergers and acquisitions of Administradoras, with a trend toward consolidation.

Also, the principal shareholders of AFPs sometime need to sell their stakes in profitable AFPs for strategic business reasons. For instance, Spain's BBVA and Netherland's ING both recently sold down or sold-off stakes in local pension funds to re-concentrate on 'core businesses'. Chile, Mexico, Peru, and Colombia in particular recently have seen waves of activity in their pension assets management industries. Chilean and Colombian asset management groups are becoming regional powerhouses in this regard, most recently illustrated by Colombian Grupo Sur Americana's purchase of ING's holdings in pension management companies in Colombia, Mexico & Peru in mid-2011.

Brazil has a unique system in the region for pension assets management. In Brazil, it is common for the leading corporate pension funds to undertake asset management for the pension funds of affiliated companies, and even to provide such services on a fee-based basis to unaffiliated entities' pension funds. But, there is great potential for expansion of this practice and for consolidation of asset management into specialized pension management companies.

Counter-Trends – It's Not Just a One-Way Street

Despite all the good things reported above, one cannot but help notice that reversal of regional trends is something of a trend in itself. As some countries have adopted more socialist-oriented practices, the attitudes to pension management have shifted in these countries as well – and it's hard to resist the pensions' 'pots of gold'. Examples include Argentina (2008), Ecuador (2010), and Bolivia (in process), while the biggest pension fund in a major regional economy like Venezuela suffers from mismanagement and likely corruption, such as occurred during 2009-2011.

Even in El Salvador, where the private pension accounts system is fairly large relative to the economy, the pension fund asset investment requirement was changed by law in early 2012 to require the private funds to increase their required investment in government certificates which fund the national PAYG social security system, from 30% of their assets, eventually to 45%.

Subscribers to ***The Guide*** are kept aware of events such as these, as well.

Closing Thoughts

The prospects for Latin America's pension funds to grow their assets, to invest capital in domestic and international capital markets and in alternative asset opportunities, and to meet their affiliates' retirement goals, currently shine like gold. In most cases, the pension funds benefit from the 'tail wind' of growing contributor bases set amid economies projected to grow solidly for the near future, and from their increasing flexibility as to how and where they can deploy their funds.

For international money managers, the region's economies and their pension markets represent tempting growth opportunities, especially when developed countries' near- and medium-term growth prospects are so poor.

In closing, let us note again our own excitement about this sector and its opportunities for international money managers, and hope that we have been successful in convincing MANAGERS of the value of the opportunities and the ways our services can contribute to MANAGERS's success.

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