International Finance Corporation
World Bank Group

Financial Sustainability of Private Pension Funds

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International Finance Corporation
Who We Are, What We Do

- IFC is the largest global development institution focused exclusively on the private sector – the global leader in private sector development finance
- We create opportunity for people – to escape poverty and improve their lives
- Driven by our vision and purpose, we make a unique contribution to development
- We invest, advise, mobilize capital, and manage assets – providing solutions for an inclusive and sustainable world

Fiscal Year 2011 Highlights

- **Investments:** 518 new projects in 102 countries
- **Advisory services**: $207 million in project expenditures
- **$18.7 billion in financing:** $12.2 billion for IFC's own account, $6.5 billion mobilized
- **$55.2 billion committed portfolio**, representing investments in 1,737 firms
- **IDA countries** account for half of IFC projects overall:
  - $3 billion invested in Latin America and the Caribbean

Financial Sustainability of Private Pension Funds ('PPF')

How to secure those financial promises made?

Topics to be considered in this presentation:

- Asset Management of supporting PPF investments
- Product design & its underlying Guarantees
- Operational Risks: friend or foe?
- Risk Management: cost or benefit?
- Lessons learnt
- The Mexico CKD Example

Financial Sustainability of Private Pension Funds

Investment Management:
The Asset side of pension obligations

Key drivers for a sustainable investment portfolio:

- Regulatory restrictions / Controls – PPF supportive & enforced
- Investment Policies – appropriate to PPF asset management
- Availability of suitable assets - risk appetite, PPF's liability profile, solvency
- View on Currency investments – benefit / danger of mismatch strategies
- Role of Government on PPF's – e.g. Risk of nationalisation, changes in taxation affecting pension assets
- General market practice – may shape the relative PPF investment practices

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Product Design & Guarantees

Liability side of future pension payments

Key issues to be considered in PPF benefit design:

- Ultimate entity who undertakes the Pension liability:

  Is this a **fund** of underlying assets .... that may be exhausted

  OR

  An obligation by the PPF to make pension payments for (say) life.

- Underlying Guarantees such as death and disability benefit included (Guarantees cost money).

- Impact of governmental regulation on private pensions (e.g. legislative requirement to increase certain pensions by annual cost of living adjustment)

Financial Sustainability of Private Pension Funds

Operational Matters

Cost and Financial risks involved in administration

- Strength of Controlling Regulation for pension providers – e.g. Limits on fees, reporting, licensing etc
- Availability & Access to Banks, Financial intermediaries for pension payments
- Critical mass / access to efficient administration systems
- Geography of pensioners population – Rural / Urban
- Requirements for ongoing Communication to pensioners / financial literacy
- Management fees allowed to be charged for pension administration services

Financial Sustainability of Private Pension Funds

Risk Management

Framework & Culture of PPF practitioners to managing uncertainties

- Regulatory controls and requirements
- Corporate governance
- Regular technical review/actuarial investigations (e.g. Longevity risk/proactive management
- Accounting & reporting standards
- Solvency and capital requirements (e.g. Adequate funding for pensions and administration asset management)
- Asset management regulation on dealing security, safe guarding of assets, trading, liquidity
- Credit/Counter party risks (e.g. risk of default)

Financial Sustainability of Private Pension Funds

Structural Solutions

Lessons from other markets

- Regional pact to diversify investment classes within the Caribbean zone while retaining savings still in the region
- Limit switchovers across funds managers to one per year or only to better performing funds, to reduce churn by agents
- Emphasize potentially less costly distribution such as bancassurance
- Regulatory limit on distribution costs / management fees to reduce leakage
- Fees on contributions are helpful at ramp up stage, fees on AUM relevant for mature business
- Pass on death / disability guarantees to third party insurers
- Uniform reporting account values on the web, daily, for transparency

Financial Sustainability of Private Pension Funds

Structural Solutions – Mandatory (Pillar II)

Lessons from other markets (continued)

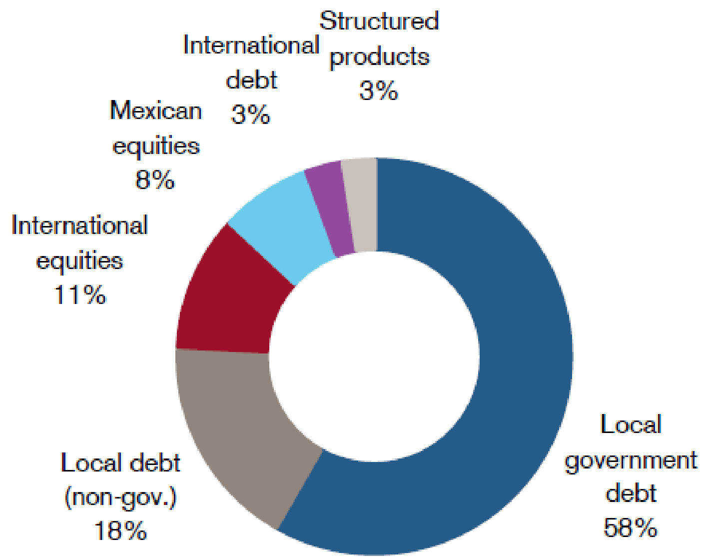
- Consider Pillar II as a fast way of increasing penetration
- Consider different asset allocation model portfolios for demographic groups
- Centralized administration, cuts down on costs, managers competing for alpha
- Foster competition by putting out new entrants in any given year to bid, to encourage new entrants who don’t otherwise have scale

Mexico Pension Industry

Industry Overview

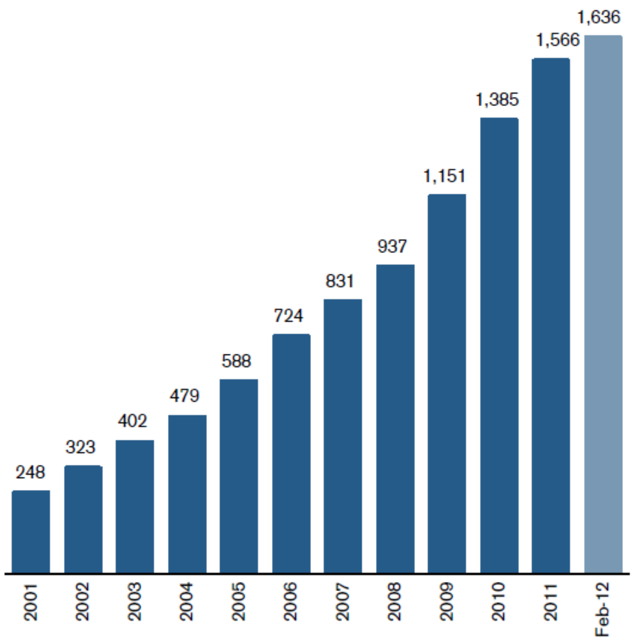
Mexico pension funds ("Siefores") are financial institutions that manage and invest the mandatory contribution pension savings.
Assets Under Management ("AUM") in 2001: US$18 billion
AUM as of February 2012: US$121 billion
Beneficiaries today: over 41 million (was less than 18 million in 2001)
Pension funds have significant portfolio concentration (as illustrated in chart below)
New regulation will allow pension funds to diversify away from government securities

Assets under management by type of security



Assets under management

(MX$ in billions)

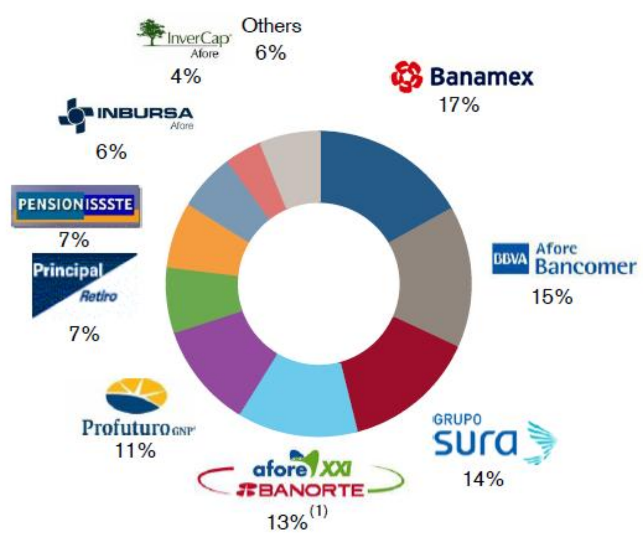


Mexico Pension Industry (Cont'd)

Siefores

- Mexican regulators introduced in August 2009 regulatory changes to create a new asset class known as Certificados de Capital de Desarrollo or Development Capital Certificates ("CKDs")
- Regulators intention was to:
  1) help pension funds ("Siefores") overcome certain legal restrictions which limit their investment to publicly offered securities,
  2) allow pension funds to diversify their portfolios and access private equity, infrastructure and real estate projects through the CKD structure, which had previously been banned,
  3) create sources of capital for Mexican companies and infrastructure or other projects in Mexico and, in turn, support economic growth.
- Siefores are the most important institutional investors in the Mexican financial markets, with significant funds under management, of which 10% (US$10 billion+) can now be allocated to CKDs.
- Pension funds in market: 9 pension funds account for 94% of the market (as illustrated in chart).

Assets under management by institution



Mexico Pension Industry (Cont'd)

CKDs

CKDs are structured equity securities.

Certificates are structured through Mexican trusts created to issue the CKDs, which are placed and offered through public offerings on the Mexican Stock Exchange.

Two types of CKDs: 1) those issued to finance an individual company or project located in Mexico, and 2) those issued to finance a private equity fund.

Currently, there are 18 CKDs in the Mexican market with total offerings of US$2.96 billion.

All CKDs in the local market were pre-funded by investors, mainly Siefores.

	Number of CKD Offerings (including reopenings)	Total Proceeds from Offerings
2009	4	US$0.890 billion
2010	9	US$1.600 billion
2011	5	US$0.470 billion
Total	**18**	**US$2.960 billion**

Mexico Pension Industry (Cont'd)

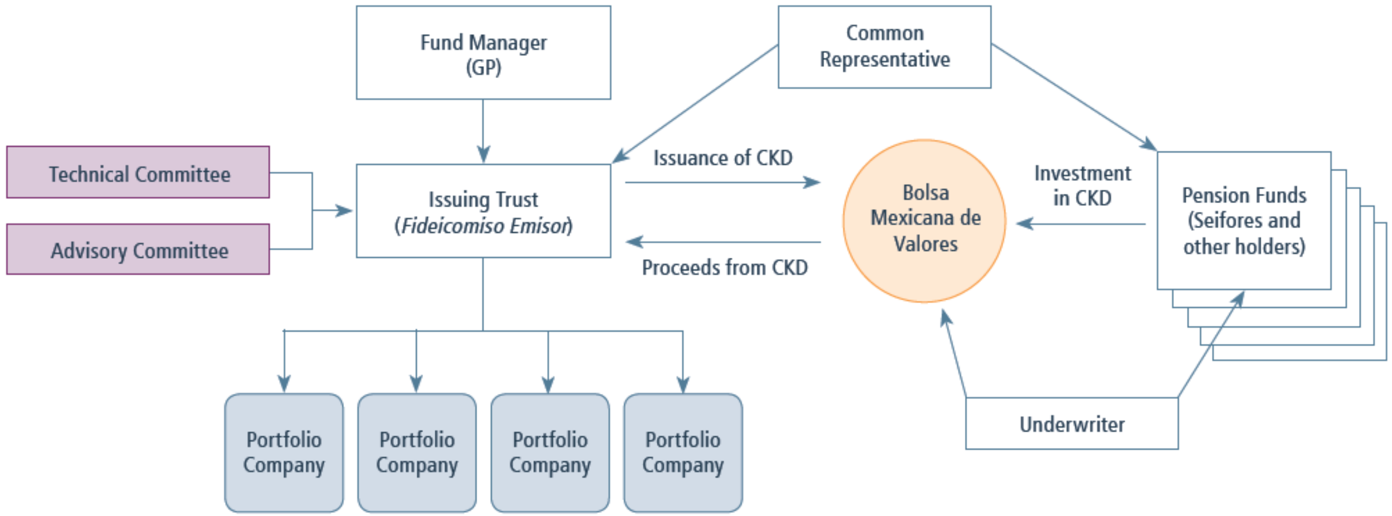
IFC Project

IFC is contemplating an investment in a new trust in the market, which will have a CKD structure. The trust will invest in credits (for e.g. loans or subordinated debt) of medium and small firms ("SMEs") in Mexico, which are currently under-banked.

Benefits of trust:

- ✓ provide greater access to capital for these SMEs
- ✓ help the local pension funds further diversify their assets under management as it will provide them access to new securities, which they previously did not have.
- ✓ better risk-adjusted returns for pension funds.

Structure



Source: CKD prospectuses, IFLR.

Thank you.

Questions?