



PENSION NOTES

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Investment Portfolios of the Latin American Pension Funds

EXECUTIVE SUMMARY

The investment portfolios of the Latin American Pension Funds (PF) currently have significant differences between them (see Table 1). Colombia, Chile and Peru, the first 3 countries to implement individually-funded systems, have more diversified investments by instrument categories in Fixed Income (FI) and Equities (Eq.) (between 40% and 60%, respectively), while the Dominican Republic, El Salvador, Costa Rica and Kazakhstan, countries whose individually-funded systems are less mature, have more than 80% of their portfolios invested in FI instruments and a significant part of them in government securities.

Investment in government securities fluctuates between a minimum of 19.4% of the portfolio in Chile and a maximum of 79.2% in El Salvador.

Investment in local companies, both in FI and Eq., fluctuates between a minimum of 1.4% in Costa Rica and a maximum of 31% in Mexico.

Investment in the local financial sector fluctuates between a minimum of 2.2% in Mexico and a maximum of 21.1% in Chile.

Peru leads foreign investment, with 44.9% of the portfolio, followed by Chile (43.6%) and Colombia (35.3%). The Dominican Republic and Kazakhstan are at the other extreme, with no foreign investment.

Despite the large FI differences in the investment portfolios, almost all of them have high real historical annual returns (since the

beginning of their respective individually-funded pension systems), with Chile leading the ranking at 8.2%, Colombia at 7.5%, Uruguay at 7.4% and Peru at 7.0%. As expected, the poorest performance, although always positive and of significant magnitude, occurs in the individually-funded systems of countries that have little or no investment in FI instruments. The large FI differences in the investment portfolios of the PFs in Latin American countries could be explained by the following: maturity of the individually-funded pension systems, investment regulations, development of local capital markets and the existence of Multifunds.

If the diversification of the investment portfolios of the PFs is analyzed over an extended period of time (see Chart No. 1), one can observe:

- A drop in investments in government securities over time (very significant at the outset of the systems), stabilizing at values between 30-40% of the total.
- That investment in corporate instruments (local companies) fluctuates between 20-30% of the total.
- A drop in investment in financial instruments, mainly bank debt, stabilizing at just over 10%.
- A significant growth in foreign investment, remaining close to 30% of the portfolio in recent years.

INTRODUCTION

Pensions Note 25 was published in May 2018, containing a comparative analysis of the investment portfolios of the PFs of Colombia, Costa Rica, Chile, El Salvador, Mexico, Peru, the Dominican Republic and Uruguay, with data to December, 2017.

After two years, it would be appropriate to update this analysis with the portfolios of the pension funds to December, 2019.

INVESTMENT PORTFOLIOS

Table 1 shows the portfolios of the PFs of the FIAP member countries with mandatory individually-funded contributory systems, to the end of 2019, ordered (from left to right) as of the year in which they started operating.

TABLE 1

INVESTMENT PORTFOLIO OF PENSION FUNDS AT 31/12/2019									
	CHILE	PERU	COLOMBIA	URUGUAY	MEXICO	EL SALVADOR	COSTA RICA	DOMINICAN REPUBLIC	KAZAKHSTAN
Start of Operations	1981	1993	1994	1996	1997	1998	2000	2003	1998
STATE	19,4%	23,1%	37,9%	51,7%	50,9%	79,2%	64,8%	77,5%	51,8%
CORPORATE	14,6%	20,7%	11,2%	19,2%	31,0%	5,6%	1,1%	4,8%	34,4%
FI	7,3%	7,0%	1,8%	10,5%	25,3%	5,6%	1,1%	4,8%	31,9%
Eq.	7,4%	13,6%	9,4%	8,6%	5,7%	0,0%	0,0%	0,0%	2,5%
FINANCIAL SECTOR	21,1%	10,8%	13,3%	5,4%	2,2%	7,5%	17,2%	11,4%	8,8%
FI	20,5%	7,5%	4,8%	5,4%	2,2%	7,5%	13,9%	11,4%	6,7%
Eq.	0,6%	3,3%	8,6%	0,0%	0,0%	0,0%	3,3%	0,0%	2,1%
FOREIGN	43,6%	44,9%	35,3%	15,1%	14,3%	4,1%	14,1%	0,0%	0,0%
FI	13,8%	4,4%	7,6%	8,8%	1,3%	4,0%	0,7%	0,0%	0,0%
Eq.	29,8%	40,5%	27,7%	6,3%	12,9%	0,1%	13,4%	0,0%	0,0%
OTHERS	1,2%	0,6%	2,3%	8,7%	1,6%	3,6%	2,9%	6,3%	5,0%
TOTAL	100,0%	100,0%	100,0%	100,0%	100,0%	100,0%	0,0%	100,0%	100,0%

Note: FI = Fixed Income; Eq. = Equities.

Source: FIAP based on the official statistics of each country.

Investment in government securities fluctuates between a minimum of 19.4% of the portfolio in Chile and a maximum of 79.2% in El Salvador, almost identical to the situation in 2017. The sharp reduction in public debt investment in Uruguay is notable (72.2% in 2017 to 51.7% in 2019), while most countries slightly increased their investment in government securities.

Investment in FI and Eq. in domestic companies fluctuates between a minimum of 1.4% in Costa Rica and a maximum of 31% in Mexico. When separately analyzing FI investment by local companies, Mexico still leads with 25.3%. Peru and Colombia lead the region in FI investments, with stakes close to 10% of their total portfolios, with Uruguay ahead of Chile in third place, possibly due to the so-called Chilean “social explosion” that started in October 2019.

There are no investments in domestic corporate shares in El Salvador, Costa Rica and the Dominican Republic.

Investment in the local financial sector fluctuates between a minimum of 2.2% in Mexico and a maximum of 21.1% in Chile. Chile leads the field in FI investments in the domestic financial sector, with 20.5% of the portfolio, followed by Costa Rica with 11.5% and the Dominican Republic with 11.4%, whereas Colombia leads the FI ranking (bank shares) with 8.6%, followed by Peru with 3.3%.

Peru leads foreign investment in both FI and Eq. with 44.9% of the portfolio, followed by Chile (43.6%) and Colombia (35.3%). The Dominican Republic and Kazakhstan are at the other extreme,

with no foreign investment. When separating by FI and Eq., Peru takes a strong lead in foreign Eq., with 40.5%, followed by Chile (29.8%) and Colombia (27.7%). Chile and Uruguay lead in foreign FI, with 13.8% and 8.8%, respectively.

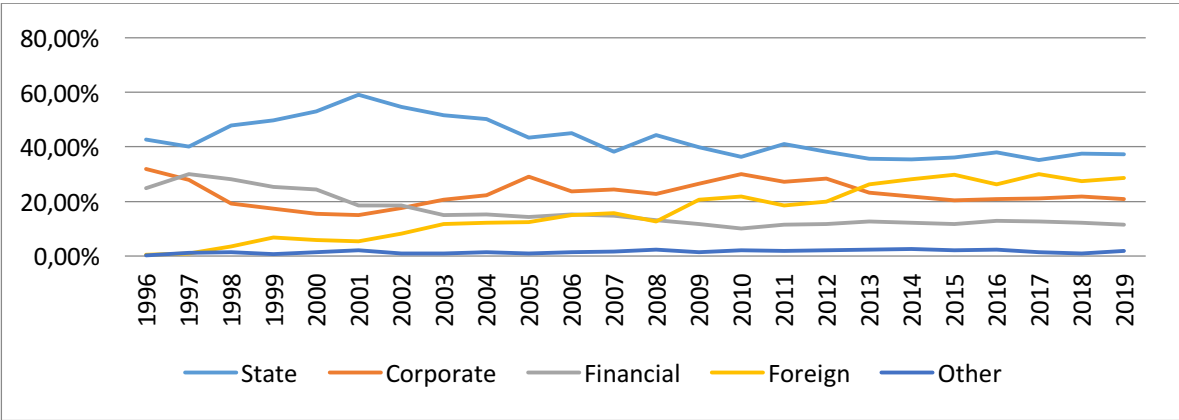
An overall analysis of the PF portfolios shows that Peru leads in FI investment (57.4%),

followed by Colombia (45.7%) and Chile (37.7%). El Salvador (96.3%), the Dominican Republic (93.7%), and Kazakhstan (90.4%) lead the ranking in FI.

A long-term outlook is required for analyzing the evolution of the PF portfolios. **Graph 1** shows all the PF portfolios of the countries analyzed in the last 25 years, approximately.

GRAPH 1

ALL PENSION FUND PORTFOLIOS BY SECTOR - FIAP COUNTRIES *



Source: Drawn up by FIAP based on information provided by FIAP Members and the websites of the agencies that regulate and/or supervise the pension systems in each country. The countries considered are: Bolivia, Colombia, Costa Rica, Chile, El Salvador, Mexico, Panama, Peru, the Dominican Republic, Uruguay and Kazakhstan.

Graph 1 shows:

- A drop in investments in government securities (very significant at the outset of the systems), stabilizing at values between 30-40% of the total.
- That investment in corporate instruments, i.e., debt and shares of domestic companies, remains stable at between 20-30% of the total, in most of the period analyzed.
- A drop in stakes in financial instruments, mainly bank debt, stabilizing at just over 10% of the total. Significant growth in foreign investment, which has remained very close to 30% in recent years.
- That other available assets have remained close to 1%, a figure that is expected to increase with greater investment in alternative assets.

DIFFERENCES IN INVESTMENT PORTFOLIOS

From the analysis of the PF investment portfolios in the countries studied, it can be concluded that there are significant differences between them, due to the following variables:

- **Maturity of the individually-funded pension systems.** The evidence shows that countries that started operating earlier have more diversified portfolios than those that started later. This, in turn, can be due to two factors: relaxation of investment rules and development of the capital market.
- **Investment regulations.** PF investment regulations that apply maximum limits per type of instrument, issuer and group of instruments affect the diversification of their portfolios in all countries. This variable correlates with the maturity of the pension systems, since at the outset they are usually only allowed to invest in domestic FI, and subsequently in local Eq., in alternative assets, abroad etc.

On comparing investment portfolios with the limits by type of instrument in different countries, it is evident that there are some limits that seem to be more restrictive, preventing further diversification:

- **Peru:** Depending on the multifund, between 5% and 10% in Peruvian corporate bonds. Sub-limits are applicable to alternative instruments and range from 4% to 12% for the moderate fund (Type 2 Fund) and 6 % to 15% for the aggressive fund (Type 3 Fund).
- **Uruguay:** The impossibility of investing in Eq. and foreign Alternative Assets.
- **Dominican Republic:** No foreign investment.
- **Colombia:** 2.5% of the PF in COP/USD spot or derivatives transactions, in the

last 5 business days, which prevents them from being more effective in hedging and foreign exchange exposure.

- **Mexico:** In December 2019, Mexico switched to a Target Date Funds (TDF) system, which allows for greater risk diversification. However, the foreign securities investment limit of 20% for all PFs is still in place.

It is worth mentioning that there are also restrictions on PF investments by issuer, or other provisions contained in the extensive regulations of each one of the countries, but due to their complexity, they will not be considered in this analysis.

A particular case is the minimum investment limit in government securities in El Salvador. Although the reform carried out in 2017 resulted in a restructuring that reduced the amounts of these government securities in PF portfolios from 45% to 38%, this minimum limit should simply not exist, since it does not seem reasonable that the savings of workers should mandatorily finance the governments of their countries, because there is considerable risk that it will be at subsidized interest rates. This is precisely what has happened historically in El Salvador, as evidenced by the significant increase in the interest rate that these instruments accrue, from 2.5% to 6%, contemplated in the reform carried out in 2017. Likewise, said reform took a positive step in opening new foreign investment options, but the Central Bank of El Salvador determined that the Fund Managers cannot operate directly in international markets, so they are forced to acquire foreign instruments through the local Stock Exchange.

One of the reasons for encouraging investment in government securities is to facilitate the transition from a PAYGO to an individually-funded pension system. During this transition, part of the contributions of active workers finance the pensions of the former PAYGO system. The fact that the PFs acquire government securities may smooth the transition to an individually funded system in the short term, but, if this policy continues to be applied in the mid and long term, the benefits of the change to the individually-funded pension system will be reduced (for example, overall savings, economic growth and the development of capital markets).

- **Development of local capital markets.** In addition to the restrictions imposed by investment regulations, another important factor that explains the lack of diversification in some countries is the

limited development of their local capital markets. These are generally smaller countries. For example, it is noteworthy that the PFs in El Salvador, Costa Rica and the Dominican Republic do not own shares in local companies, despite being authorized to do so. Precisely in those countries that do not have a developed local capital market, it is essential to promote their development and effectively authorize foreign investment by the PFs, in order to achieve adequate diversification of their portfolios.

Table 2 shows the main stock market indicators. When analyzing the Market Capitalization indicators and the Number of Domestic Stock Transactions, it can be concluded that the stock markets in Uruguay, Costa Rica and El Salvador are still very small and non-existent in the Dominican Republic.

TABLE 2

CAPITAL MARKET (USD MILLIONS) DECEMBER 2019				
	Market	N° of national	N° of Domestic	N° of investment
	Capitalization	Companies	Stock Transactions	funds
CHILE	208,253	203	43,172	1,257
PERU	100,651	196	2,041	8
COLOMBIA	132,572	66	13,890	-
URUGUAY*	234	7	4	11
MEXICO	413,883	139	83	576
EL SALVADOR	4,813	71	0	-
COSTA RICA	2,277	10	36	28

Source: Federación Iberoamericana de Bolsas (FIAB - Ibero-American Federation of Stock Exchanges). Information regarding Uruguay was obtained from the Central Bank of Uruguay: www.bcu.gub.uy

When comparing Market Capitalization with the size of the pension funds (Table 4), Peru and Mexico lead with 190% (Market Capitalization almost doubles the size of the PFs), followed by Colombia

(143%), Chile (94%), El Salvador (41%), Costa Rica (19%) and Uruguay (2%). The Dominican Republic (0%), does not have a stock market.

Furthermore, if we analyze the ratio between the number of domestic share transactions and the PFs, Mexico leads with 38%, followed by Chile (20%), Colombia (15%) and Peru (4%). In Uruguay, El Salvador, Costa Rica and the Dominican Republic, this ratio is not even 1% of the PFs, which shows the need to strengthen their internal stock markets, which are small (low market capitalization), with companies with very concentrated property (low amounts traded).

- **Multifunds.** The evidence suggests that countries with multifunds show greater diversification than those that manage one or two funds. This makes sense, since

a greater range of instruments is required to form different investment portfolios. However, this variable seems to be related to the previous ones. Another aspect to highlight is that in a system with Multifunds, it is the workers who choose how to invest their pension savings, assuming a higher or lower degree of risk.

RETURN OF THE PENSION FUNDS

Table 3 shows the real annual returns, in domestic legal tender, of the funds of each one of the countries, in two time periods: the year 2019 and from the outset or startup of each system.

TABLE 3
Real Return in Domestic Legal Tender

Year	Colombia	Costa Rica	Chile	El Salvador	Mexico	Peru	Dominican Republic	Uruguay
2019	13.1%	12.4%	15.5%	4.2%	12.3%	10.8%	6.9%	5.0%
historical	7.5%	5.2%	8.2%	3.3%	5.4%	7.0%	5.4%	7.4%

Weighted average return of each one of the multifunds, when applicable. In Colombia it is called the moderate fund and in Uruguay the accumulation fund.

Source: FIAP based on the official statistics of each country.

When comparing the 2019 returns, those countries with greater investment in Eq. and foreign instruments have higher returns, given the good performance of global stock markets last year.

When analyzing the real annual returns of each one of the systems from the outset (note that we are considering different

periods, namely 38 years in Chile and 16 years in the Dominican Republic, at the other extremity), Chile has the highest returns (8.2%), followed by Colombia (7.5%), Uruguay (7.4%), and Peru (7.0%) and the lowest performance, although always positive and of significant magnitude, compared to countries that have little or no investment in Eq. instruments.

The historical returns of the three countries with the highest investment in government equities (more than 70% of the portfolio) deserves special attention: The Dominican Republic (5.4%), Costa Rica (5.2%) and El Salvador (3.3 %). Note that the returns of the first two lead the third by two percentage points. This is due to the historical requirement of minimum investment in government securities in El Salvador and the low rates that these instruments accrue. FIAP has persistently opposed the existence of these minimum investment limits, which are particularly dangerous when applied to government securities. There is an evident political risk that non-market conditions are

set for PF investments, especially when fiscal accounts are in the red. On the other hand, the situation in Uruguay is remarkable, since with a historical investment in government securities of a magnitude similar to that of the three countries mentioned previously (currently reduced to 52% of the portfolio), it has a historical return close to that of countries with greater investment in Eq. instruments.

SIZE OF THE PENSION FUNDS

Tables 4 and 5 show the size of the PFs, expressed in US dollars, and their comparison with national GDP.

TABLE 4

Pension Funds (in millions of dollars)

	MANDATORY	VOLUNTARY	TOTAL
CHILE	215,373	5,935	221,308
PERU	52,254	691	52,945
COLOMBIA	85,963	6,514	92,477
URUGUAY	15,111	N.D.	15,111
MEXICO	214,275	3,297	217,572
EL SALVADOR	11,775	N.D.	11,775
COSTA RICA	11,982	239	12,221
DOMINICAN REP.	10,502	N.D.	10,502

Source: Drawn up by FIAP, based on information provided by FIAP members and the websites of the agencies that regulate and/or supervise the pension systems in each country.

N.D. = Not Disposable.

TABLE 5

	CHILE	PERU	COLOMBIA	URUGUAY	MEXICO	EL SALVADOR	COSTA RICA	DOMINICAN REPUBLIC
FP/PIB	81.2%	22.8%	26.5%	27.1%	16.7%	45.2%	18.8%	11.8%

Source: FIAP based on the official statistics of each country.

If we bear in mind that the countries are ordered according to the starting dates of their individually-funded pension systems, the PF/GDP ratio in Table 5 should be decreasing to the right, since countries have ever fewer years of accumulated pension savings. Thus, the low PF/GDP ratios of Peru, Colombia, Mexico and Uruguay, which are lower than the ratio of El Salvador, are

striking. This is due to the reduced coverage of the pension systems in Peru, Colombia and Mexico, caused by the strong informality of the labor market, and in the case of Uruguay, because the system is complementary to the PAYGO system still in force. Furthermore, the Peruvian PFs have been negatively affected by the massive withdrawals of pension funds.

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Queries: FIAP. Address: Avenida Nueva Providencia 2155, Torre B, Piso 8, Of. 810-811, Providencia, Santiago, Chile Phone: (56) 2 23811723, Extension 10. E-mail: fiap@fiap.cl. Web site: www.fiapinternacional.org