Partnerships and acquisitions pay off south of the border for Principal
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Principal Financial Group Inc. claimed 18% of its operating profit from money management operations in Latin America in 2013, the result of a series of bold moves in a treacherous market where few other global managers have found success.

Both Goldman Sachs Asset Management and UBS Asset Management have retreated from Brazil, the largest market in Latin America, and other U.S.-based managers have struggled to gain a foothold in the region.

Principal's success in Latin America is explained in part by its partnerships with local firms, including a joint venture with Brazil's largest bank, and buying retirement fund businesses in Chile and Mexico.

Goldman curtailed its five-year institutional effort in Brazil in early 2012, ending with only $131 million in assets under management. Goldman spokeswoman Andrea Raphael said the business was unable to reach adequate scale.

UBS also closed its local asset management unit in Brazil in 2012. UBS spokeswoman Megan Stinson did not give a reason.

Others — including Morgan Stanley (MS) Investment Management, J.P. Morgan Asset Management (JPM), Legg Mason (LM) Inc. (LM) and BNY Mellon Investment Management — have assets under management in Brazil, but they are a fraction of the dominant Brazilian banks.

Brazil's largest money manager, Banco do Brasil SA, has around $200 billion; Itau Unibanco SA is second with $150.6 billion; and Banco Bradesco SA is third with $128.1 billion, according to Brazil's National Association of Financial Institutions.

By contrast, Legg Mason's fixed-income unit, Western Asset Management Co., the largest U.S. manager in Brazil, had around $14 billion in assets as of Dec. 31, according to WAMCO data.

GSAM had hired experienced salespeople from other asset management firms but couldn't gain traction without an established partner, said Lauro Araujo, owner of investment consulting firm LAS Ltd. in Sao Paulo. “It's very difficult going against the banks,” he said.

Mr. Araujo said competition is so tight that fees are very low, squeezing margins and making it difficult for non-local firms to succeed.

He said the 12%-plus Brazilian fixed-income return until an economic downturn in 2012 meant Brazilian pension plans only invested locally. This prevented global managers from getting assets to invest outside of Brazil and forced them, unsuccessfully, to compete against local managers for Brazil-specific strategies.

Nevertheless, Principal has prospered in Brazil. A key reason: It partnered with Banco do Brasil in a joint venture called BrasilPrev. Principal owns 25% of the partnership, which started in 1999, and takes an active role in developing its investment strategies.

“It would be too difficult to succeed without an established partner in Brazil,” said Luis Valdes, president of Principal International, Des Moines, Iowa.

Banco do Brasil, with thousands of branches throughout Brazil and a large institutional sales force, helped BrasilPrev garner $9 billion in net inflows in 2012 and 2013 combined, selling individual and institutional retirement offerings, said Mr. Valdes.

He said BrasilPrev's assets totaled $37 billion in 2013. While Principal Financial's economic interest in the partnership is only 25%, the $78 million it made in operating profit in 2013 was the second biggest for its Latin American subsidiaries (behind Chile). Principal also owns a 60% stake in a small Brazilian mutual fund company, Claritas Administracao de Recursos Ltda., with around $1 billion in assets.

Most profitable

Despite Principal's success in Brazil, Chile has been its most profitable Latin American effort, stemming from the company's $1.5 billion purchase in October 2012 of AFP Cuprum SA, one of six managers within Chile's three-decades-old mandatory defined contribution system. AFP Cuprum SA earned $87.8 million for Principal in 2013, including $34.3 million in the fourth quarter, according to company data.

“Principal has been able to take advantage of a growing middle class in Latin America and build its franchise through the acquisition of firms like Cuprum that already had a significant market share in the Chilean marketplace,” Edward Shields, a Chicago-based analyst with Sandler O'Neill & Partners, said in an interview.

Cuprum has $38 billion in assets under management, a 20.7% share of the Chilean retirement plan market.

Another recent entry into the Chilean money management industry is Metropolitan Life Insurance Co., New York. The life insurer purchased AFP Provida SA for $2 billion in February 2013, taking ownership of the largest retirement plan provider in Chile, with $45 billion in assets.

One of the attractive features of the Chilean retirement plan market is that mandatory employee contributions are 10% of salary, guaranteeing inflows for companies like Principal and MetLife, said Mr. Shields.

But one unknown is what it will mean for Principal and MetLife if the Chilean government enters the field with its own offering, which could potentially undercut for-profit competitors on fees. Chilean President Michelle Bachelet has proposed establishing a government-run retirement fund that would compete against existing funds.

Martin Karish, a spokesman for MetLife, said his company just wants to see a “level playing field” to ensure the government plan does not undercut Provida's fees.

Mr. Valdes said the government proposal would not hurt Principal because it would be targeting low-income workers; Cuprum is focused on middle- and upper-class employees in Chile.

In Mexico, Principal and MetLife both own companies that participate in the country's mandatory Afore system, a defined contribution system that requires Mexican workers to contribute 6% of salary.

Shut out

Other international money management companies, without Afore ownership, have been largely shut out of the Mexican market until recently. But new rules established by the Mexican government over the past two years will allow the 13 Afores to make investments in active strategies overseas, allowing them to engage international money managers, said Javier Orvananos Marquez, chief investment officer of Afore Banamex, Mexico City.

Mr. Marquez said Banamex, a Citibank subsidiary, is in the process of investing almost $2 billion in funds run by a variety of U.S. and European money managers. Before the new regulations, overseas investments were limited to index strategies and exchange-traded funds, he added.

In Brazil, global managers might finally be making some inroads. While fixed-income yields are recovering, the economic downturn got pension officials in Brazil thinking about diversifying assets, said Mr. Araujo.

He noted that in October, Banco do Brasil's $74.5 billion employee pension fund, the Rio de Janeiro-based fund known as Previ, announced it would invest in U.S. and European stocks through funds run by global money managers.

Bruno Stein, BlackRock (BLK)'s director of business development for Brazil, based in Sao Paulo, said Previ plans to invest $3 billion with BlackRock and three other managers — J.P. Morgan, Schroders and Franklin Templeton (BEN).