Making Finance Work for Africa

Pension Funds in Botswana, Kenya, Namibia and Nigeria: New Avenues for Funding Private Equity

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February 2016

New research from PricewaterhouseCoopers (PwC) forecasts that pension funds assets under management (AuM) in 12 African markets will rise to around USD 1.098 billion by 2020, from a 2008 total of USD 293 billion[1]. AuM by the Nigerian pension industry for example, are growing at around 30% per year, rising from USD 7 billion in December 2008 to USD 27 billion in October 2015. The growth in assets under management is creating pressure for diversification, both from a risk management and return perspective. African pension funds have traditionally not invested in alternative assets, but the growth in AUM and an increasingly liberal regulatory regime is now making it possible for them to do so.

This Brief builds on the joint MFW4A, EMPEA and the Commonwealth Secretariat publication, *Pension Funds and Private Equity: Unlocking Africa's Potential* to further explore the approach of pension funds in Botswana, Kenya, Namibia and Nigeria to private equity (PE), with a particular focus on the latest national regulatory changes.

Regulation has long been seen as the main stumbling block to investment in private equity by African pension funds. However, reforms in some of the continent's key markets are making it possible for local institutional investors to participate in private equity. The four countries covered in this brief all have a specific allocation to private equity. Namibia is the exception, with an express requirement for pension funds to invest a minimum of 1.75% of assets in the asset class.

Country	Currency	AuM in Billions (Latest Data available)	AuM in 2013 in Billions	Allocation to PE in 2016	Available for PE in billions (Latest data available)	Invested in PE in millions (Latest data available)	Increase in investment in PE compared to previous year
Botswana	USD	5.22	6	5%	0.261	125.6	0.2%
	BWP	59.4	53.2				
Kenya	USD	7.7	7.28	10%	0.77	44.6	15.48%
	KES	788.15	633.46				

[1] **Source:** *Africa Asset Management 2020* - Report by PwC examining the asset management industry across 12 African countries (Algeria, Angola, Botswana, Egypt, Ghana, Kenya, Mauritius, Morocco, Namibia, Nigeria, South Africa, Tunisia)

Namibia	USD	7.45	9.96	1,75 - 3,5%	0.261	121.7[2]	46.15%
	NAD	119.6	105.3				
Nigeria	USD	25.8	25	5%	1.29	87	56%
	NGN	5150	4100				
TOTAL (USD)		46.17			2.58	378.9	

Hard figures for investments in private equity are readily available for the four countries covered. However, based on the data gathered in our research and discussions with various regulators and pension funds, we estimate, as indicated in the table above that there is USD 2.58 billion that could potentially be invested today in private equity in the four countries covered. This is almost seven times the amount currently invested. Investment in private equity is also increasing - sometimes at a faster rate than AUM, as in Namibia and Nigeria. Depreciation of local currencies in markets like Nigeria means that AuM growth has slowed in dollar terms. However, because the assets and liabilities of the pension managers are reported in local currency, the challenges of successfully managing rapid growth remain.

In Nigeria, where private equity has been an allowable asset class since December 2010, with a limit of 5%, investment in the asset class was estimated at USD 87 million in October 2015. This represents a 56% increase from December 2014, on asset base of USD 25.8 billion, which itself increased by 11,6% in 2015. Nigerian law requires also a minimum 75% of the private equity fund to be invested in Nigeria, registration of the fund with the Nigerian SEC, and a minimum investment of 3% in the fund by the General Partners (GP). Such qualitative restrictions, especially with respect to geography/jurisdiction, are typical on the continent.

In an effort to further encourage pension funds to use private equity to diversify risks, the regulator plans to lower the 75% requirement to 60% in 2016. Nigeria also aims to have 40% of pension funds AuM invested in “alternatives assets” by 2019. Focus sectors include housing, energy and transport. Thus, even though the relative complexity of the current regulation may be one of the reasons behind the low investment in the asset class so far, there is every reason to believe that we will see increased investment in private equity by Nigerian funds in the future.

AuM in Kenya grew by 13.1%, to USD 7.7 billion, between December 2013 and December 2014. Investment in private equity increased by 15.48%. Private equity investment was allowed under the general “other assets” category with a limit of to 10% until 2015, subject to 1) conformity with the pension fund investment policy, 2) a “no-objection” from the Retirement Benefits Authority (RBA). There is now a specific private equity allocation of up to 10%, and the requirement to seek RBA approval has also been removed. However the private equity fund manager must be approved by the Capital Markets Authority (CMA), a procedure for which there are no guidelines. The CMA is planning a regulatory update in 2016. It is also worth noting that most pension fund investment policies do not include private equity, partly because the specific allocation is so recent. These policies need to be updated to unlock further investment in the asset class.

[2] This figure is based only on the GIPF financial statements. The GIPF is the largest Namibian pension fund, representing as of 2014 71% of total Assets under Managements in Namibia. http://www.gipf.com.na/downloads/Downloads/Annual%20Reports/2014.pdf

Namibian pension fund assets increased by 13.6% to USD 7.45 billion at the end of 2014. Investment in private equity asset class grew by 46.16% over the same period. The Government Institutions Pension Fund (GIPF), the largest pension fund, has earmarked USD 200 million for an unlisted investment portfolio to invest in local private equity projects (out of 260.75 million currently authorised by the regulation for private equity). Regulation 29, formally implemented in 2015, requires institutional investors to invest by 2017 a minimum of 1.75% (and a maximum of 3.5%) of their assets in unlisted assets, which will increase further the availability of capital for private sector enterprises.

Pension funds in Botswana, were allowed to invest up to 2.5% in PE under the general "other assets" category before 2015. NBFIRA Revised Pension Prudential Investment Rule (PFR 2) issued in October 2015 now allows pension funds to invest up to 5% in the asset class. Investment in private equity by Botswana pension funds appears to be significant compared to other countries (USD 125.6 million as of 2015 out of a potential USD 261 million), however few funds have the size and internal capacity to be able to invest in this asset class.

High returns offered by other asset classes, notably government bonds and listed securities have historically been a disincentive for African funds to invest in PE. However as macro-economic stability improves, the returns on bonds will likely fall, making private equity a more attractive option. The average coupon of bond issues in Namibia, for example was 8.76% in 2014 compared to 10.10% in 2010 and in Botswana 7.75% in 2014 compared to 8.51% in 2010 (Sources African Financial Market Initiative (AFMI) www.africanbondmarkets.org/en/). According to the African private equity benchmark index, the annualised return of private equity on the continent in 2013 was 11.2%.

Beyond returns, there is a critical need to strengthen the pension funds, regulators and policy makers' understanding of the asset class. The private equity industry has made significant strides in its advocacy role, producing research and analytical papers to better inform pension funds managers, regulators and policy makers. In addition, industry associations, with the support of a number of Development Finance Institutions, have been running Private Equity Master Classes for local investors for many years. Regulators also are playing their part in clarifying and progressively liberalising regulations as market conditions allow. Industry players should support such initiatives by getting a deeper understanding of local pension funds needs and concerns. They should work with them and the regulators to create structures that enable them to work within the current regulatory framework. This approach has been followed with some success in Latin America, as described in "Pension Funds and Private Equity – Unlocking Africa's Potential.

The lack of a common local platform in many countries for private equity managers to discuss and collectively address their needs and concerns with the regulator is an obstacle, given the local (i.e. country specific) nature of regulation on the continent. However, as assets under management is growing to significant proportions of GDP in countries like Namibia (80%) and Botswana (40%), there will be fewer domestic opportunities able to provide the capital protection and diversification necessary for pension funds to meet their obligations. This will create further pressure for both pension fund managers and regulators to explore the alternative asset space. Africa's investment needs, the global discourse on financing for development, and the role of domestic resources within that, all point to African pension funds playing an increasing role in the private equity industry in the medium term.

The Making Finance Work for Africa (MFW4A) Partnership was established by the then G8 in the 2007 Heiligendamm Declaration. The objective of the Partnership is to facilitate a scale-up in support for financial sector development in Africa, overcome fragmentation and increase aid efficiency by addressing key constraints to efficient development partner support within country-owned development plans. MFW4A's strategy for 2015 – 2017 focuses on three strategic thematic areas: (i) Financial Inclusion; (ii) Long-Term Finance; and (iii) Financial Stability and Governance. The MFW4A Secretariat has been hosted by the African Development Bank since 2008, and is central to the delivery of the Partnership's mandate. www.mfw4a.org