

# INVESTING PENSION ASSETS IN LIMITED CAPITAL MARKETS



**WORLD BANK GROUP**

Pension Core Course 2015

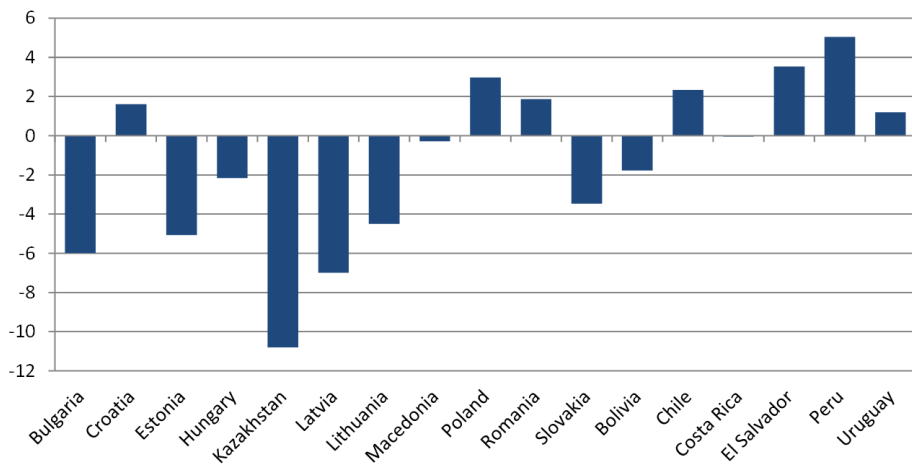
Fiona Stewart

# PENSION FUNDS AND ECONOMIC GROWTH?

- Strong theoretical argument – pension funds asset growth spurs capital market development (as source of long-term financing) which fuels economic development
- Evidence from some countries that this has / can work (particularly in LAC, also examples in Asia – Spore/ Malaysia – and happening in Africa- Kenya leading)
- Put also plenty of disappointments
- Lessons learnt around:
  - Macro environment
  - Regulatory environment
  - Creation of investment vehicles
  - Capacity building / sharing

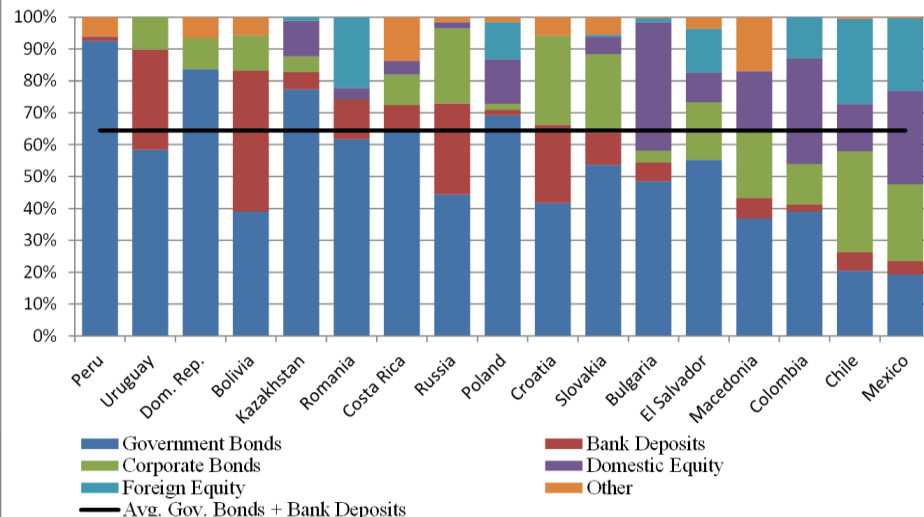
# Investment Diversification – has disappointed in some countries / and investment has suffered

**Average Return Minus Wage Growth (%)  
(2000-2012 or available period)**



Source: World Bank Pensions Database

**Portfolio Composition (% of total assets)**



Source: World Bank Pensions Database

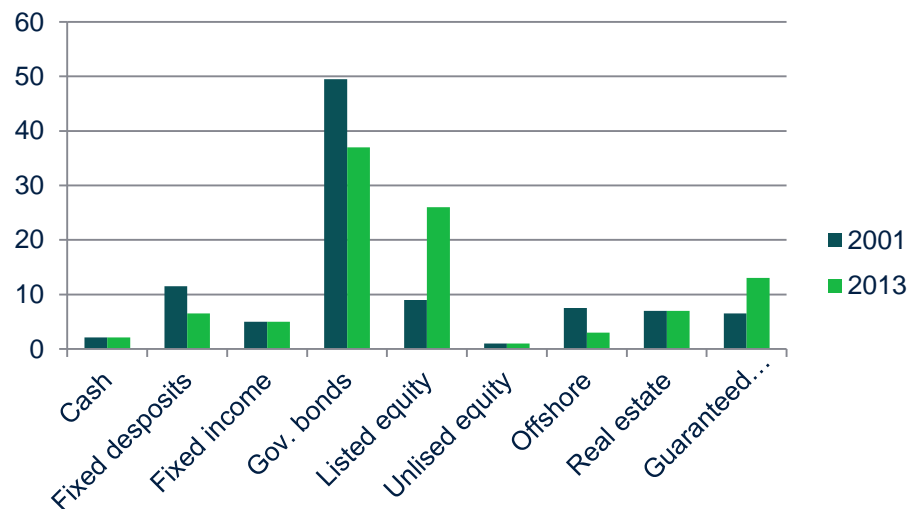
## Investment Diversification - Solutions

- **Longer-term government debt issuance** – more appropriate investments for pension funds/ helps build benchmark yield curve / allows for more corporate debt investment
- **Creation of other investment instruments specifically for pension funds** – infrastructure/ real estate/ private equity
- **Some regional / overseas investment** - provides sufficient diversification + liquidity

# Kenya - Longer-term Instruments

- **Largest portfolio shift from government bonds to domestic equity**
- **Duration of bond portfolio lengthened** - holdings of long term government bonds (10 years tenure and over) have risen (from 25% of total government bond holdings to 31.5% between the end of 2010 and mid 2013). The recent introduction of the 30 year Sovereign Development Bond was said to be well received by the pension funds.
- **Infrastructure bonds** - issued by the government also popular with pension funds.

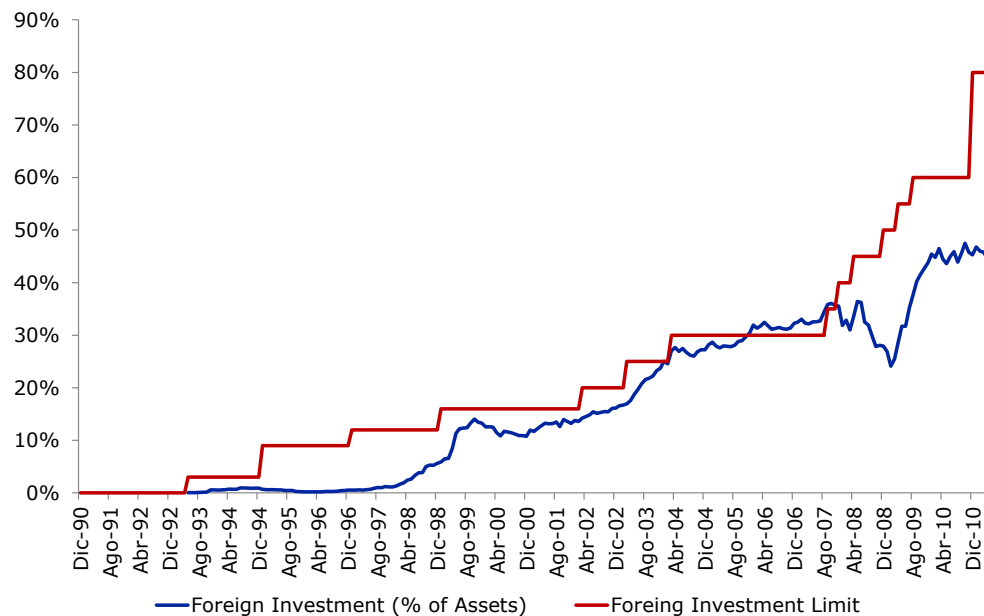
## Pension Fund Portfolios 2001 vs. 2013



# Chile – International Diversification

- Relaxing of the domestic investment requirement coincided with the increase in pension fund assets as a percentage of GDP
- Given the mandatory level of savings, pension assets were seen to be increasing beyond the capacity of domestic markets to absorb
- South Africa have linked overseas limits + capital flows

## Development of Investment Abroad vs. Investment Limits

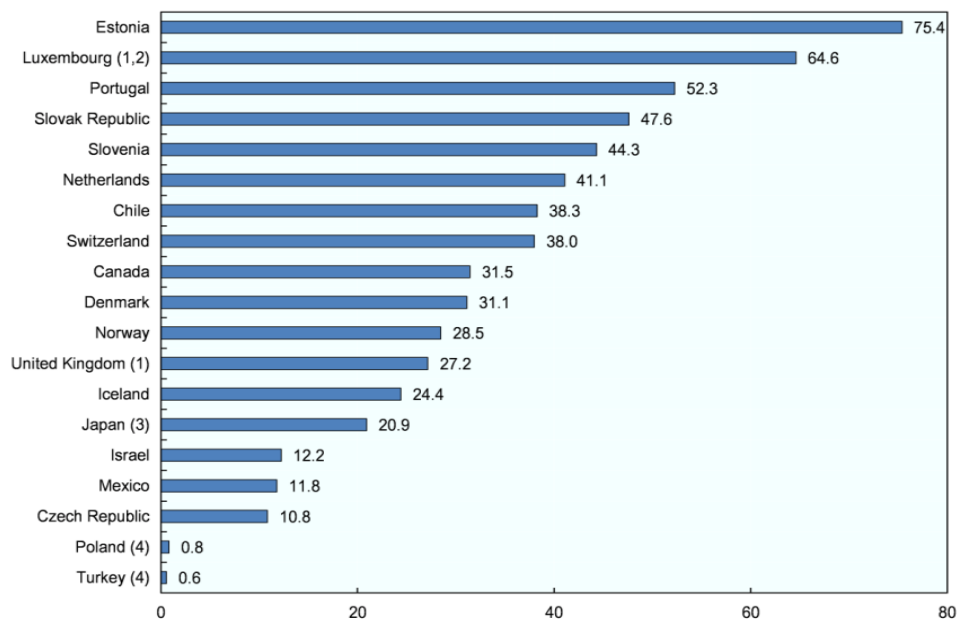


Source: Supintendencia

# International Diversification

- Most EAC consider EAC investments as domestic
- Some Africa examples of high international exposure:
  - Lesotho= 90% regional (South Africa) and international
  - Namibia= 1/3 domestic/ 1/3 South Africa/ 1/3 international

## Foreign Investment in Selected OECD Countries (% portfolio 2012)



Source: OECD

# Mexico – Creation of investment instruments



## CURRENT INVESTMENT OPPORTUNITIES COMPRISE THE MAJORITY OF ASSET CLASSES USED BY INTERNATIONAL PENSION FUNDS

Currently there are six asset classes:

Asset classes allowed within the Investment Regime of Pension Funds																
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
<b>Debt</b>	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
<b>Currencies</b>	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
<b>Equity</b>	✗	✗	✗	✗	✗	✗	✗	✗	✗	✓	✓	✓	✓	✓	✓	✓
<b>Structured Securities: CKDs (Mexican Private Equity) y FIBRAS (Mexican REITs)</b>	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✓	✓	✓	✓	✓
<b>Securitizations</b>	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✓	✓	✓	✓	✓
<b>Commodities</b>	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✗	✓

Within each asset class, restrictions have been relaxed: international stock picking (thru mandates), international debt with investment grade, relaxed issuer limits for debt, etc.

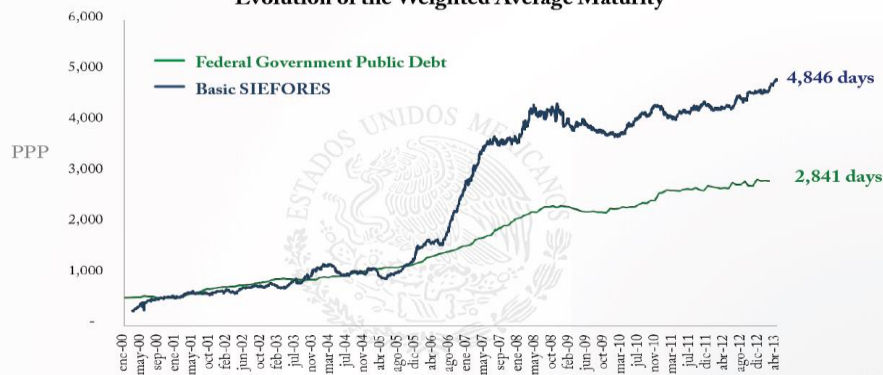


# Mexico – Creation of investment instruments



PENSIONS FUNDS ARE INCREASING THEIR PORTFOLIO DURATION CONSISTENT WITH THEIR LONG TERM OBJECTIVE

Evolution of the Weighted Average Maturity



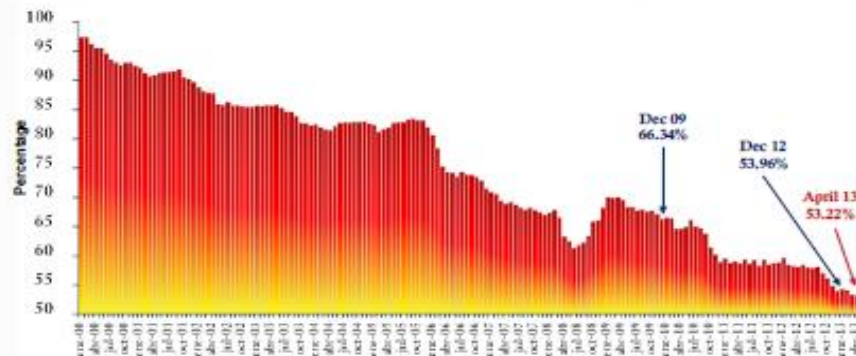
Figures at the end of April 2013. Information of the Federal Government Public Debt by the Central Bank last published date (February 2013). Source: CONSAR Financial Vice-Presidency

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THIS BROADER SET OF INVESTMENT OPPORTUNITIES HAS TRANSLATED INTO A LOWER CONCENTRATION IN SECURITIES ISSUED BY MEXICO'S FEDERAL GOVERNMENT

Participation in Government Securities in the Pension Funds portfolios



Figures in millions of pesos at the end of April 2013. Source: CONSAR Financial Vice-presidency

# POTENTIAL INSTITUTIONAL INVESTOR FINANCING

Institutional Investors	AuM USD	Current Investment in Infrastructure	Asset Allocation Scenario - Infrastructure	Current Investment in EMDE	Potential Investment in EMDE Infrastructure	Comments
OECD Institutional Investors	USD 80 tn	1% on average implies USD 800bn - mostly in OECD	Increase to 3% (5%) on average implies USD 2.4tn (USD 4tn)	Estimated 10% in EMDE in general - but very small in infrastructure	5% EMDE of 3% in infrastructure = USD 120bn	Limited by both supply (e.g., available projects and assets) and demand factors (capacity, investor regulation, liquidity needs)
		Leading investors: 5-10%			10% EMDE of 5% in infrastructure = USD 400bn	
Emerging Market Institutional Investors	USD 5tn	< 1% on average - 0.5% would imply USD 25bn	Increase to 3% on average implies USD 150bn	High percentage in EMDE	80% EMDE of 3% = USD 120bn	Growth potential - e.g., EM pension funds currently \$2.5 trillion AUM estimated to rise to USD 17tn by 2050
		Even more limited than OECD investors			70% EMDE of 5% = USD 175bn	
Of which: EMDE PPRFs/SSFs	USD 1tn	Limited - some examples - up to 10%)	Increase to 5% implies USD 50bn	High percentage in EMDE	70% of 5% assets = USD 35bn	High targets - often the largest source of capital in a developing country
Sovereign Wealth Funds	USD 4tn	Unclear - 2% implies USD 80bn	Increase to 5% implies USD 200bn	Relatively high in EMDE	30% EMDE of 3% in infra = USD 36bn	Many new EM SWF being set up to specifically invest in domestic infrastructure
					50% EMDE of 5% in infra = USD 100bn	
Other global institutional capital (asset / wealth managers)	USD 20tn	Assumed 1% on average implies USD 200bn	Increase to 3% on average implies USD 600bn	Very small in EMDE	10% EMDE of 3% in infrastructure = USD 60bn	
<b>Total</b>					<b>USD 350 - 700bn</b>	
<b>Annual flows</b>	<b>(over 10 years)</b>				<b>USD 30 - 60bn</b>	

# Enhancing Institutional Investors Role in Infrastructure

## KEY BARRIERS

- Country selection and suitability
- Lack of well-prepared projects
- Lack of understanding of asset class
- Policy, Regulatory and capital market constraints
- Inadequate 'institutional investor-friendly' frameworks
- Lack of innovative vehicles and risk mitigation instruments for N-S and/or domestic investment

## HOW WBG CAN ADDRESS?

- Conduct country suitability assessment
- Preparation of high credit quality projects
- Provide targeted capacity building
- Pension and regulatory reform. Improve capital markets for infra bonds
- Develop institutional investor-friendly PPP Frameworks and
- Design and implement innovative instruments and vehicles
- Define role and products of (M)DBs

**WBG teams can collaborate to improve the enabling environment for Institutional Investors to invest in infrastructure**

# Local Currency Bond Market Asset Class - Colombia FDN Project

## PROBLEM

- A USD 26 bn pipeline of toll roads and other growing infrastructure needs
- Low exposure to foreign investors
- Insufficient /expensive funding local banks
- Incipient bond market: 5.6 % of GDP
- Large but very concentrated pension fund industry: USD 80 billion (20 % of GDP), 4 pension funds (2 hold 80 % of assets)
  - Exposure to infrastructure is minimal, in spite of strong interest
  - High risk aversion (AA+ or above)
  - Expected investments through a variety of instruments: infrastructure funds and project bonds

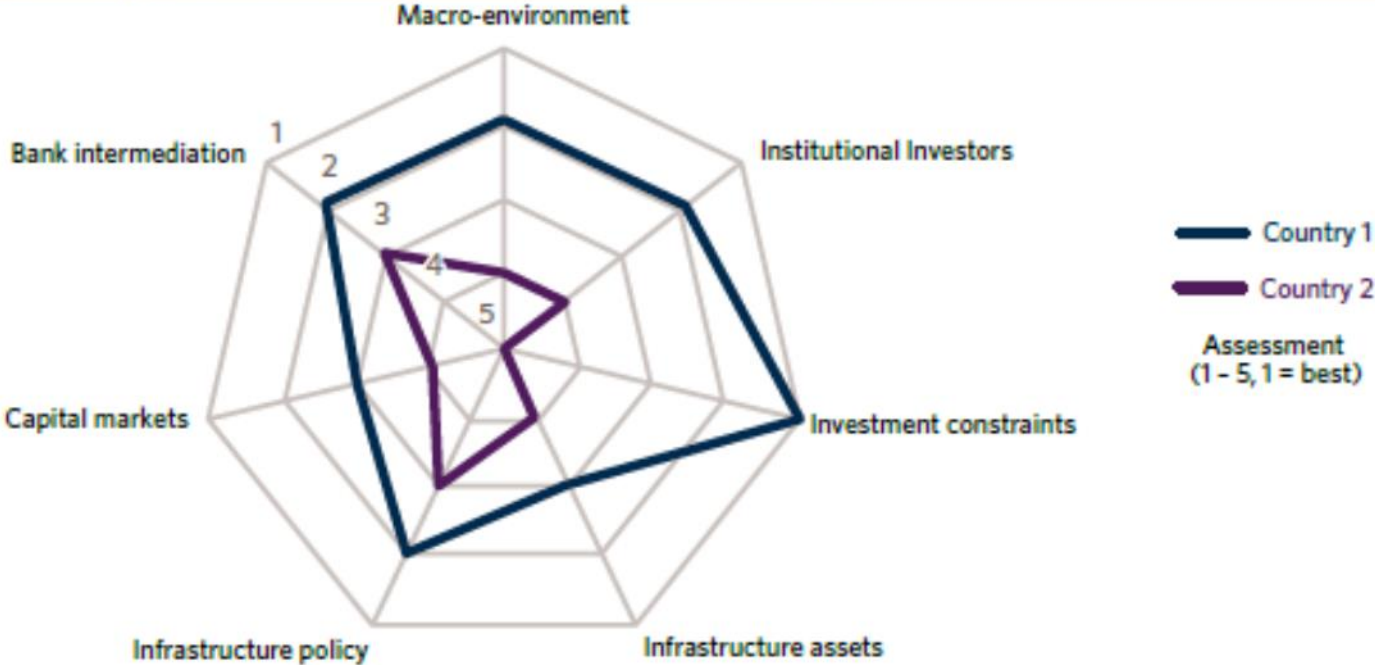
## SOLUTIONS

- Strong coordination policy/implementation:
  - MoF, National Infrastructure Agency (ANI)
  - Financial Sector Superintendency
  - National development bank with catalytic approach (FDN)
- Standardization of toll road project contracts
- FDN acting as champion of financial solutions
- Development of a variety of instruments with emphasis on project bonds:
  - Take out guarantees from loans-to-bonds
  - Day-zero project bonds with credit enhancements
  - Liquidity guarantees for bond servicing
  - Infrastructure bond funds
- Pension funds engagement and training
- Regulatory reforms fixed income / banking

**Broad engagement WBG teams: F&M building bond markets; PPIAF TA improve capacity of Institutional Investors; IFC investments in FDN; IFC Treasury possible bond guarantee; Transport Global Practice and CMU supporting project preparation activities**

# On-going work: Country Mapping vs. Investor Financing Vehicle

Figure 17: Country Assessment for Institutional Infrastructure Investment



Source: Authors

# On-going work: Country Mapping vs. Investor Financing Vehicle

	Country A	Country B	Country C
<b>Sovereign credit rating</b>	At /close to investment grade	Below investment grade	No rating
<b>Size of pension fund AUM (% GDP)</b>	> 10%	1-5%	Minimal
<b>Number of pension funds</b>	10s or 100s	A few main funds	Dominant social security fund
<b>Quality of pension system (e.g., Mercer Global Pensions Index)</b>	D	C	E
<b>Insurance penetration (% GDP)</b>	High	Medium	Minimal
<b>SWF</b>	Yes	Yes	No
<b>Development Fund or Bank</b>	Yes	No	Yes
<b>Level financial sector</b>			
- Bank assets (% GDP), - Private credit (% GDP)	Medium	Low	Fledgling
<b>Level capital market</b>			
- Stock market cap (% GDP)	High	Medium	Low
<b>Business conditions (e.g., IFC Doing Business ranking)</b>	Good	Average	Difficult
<b>Infrastructure investment conditions (e.g., EC Harris Global Infrastructure Investment Index, or Nabarro Infrastructure Index<sup>25</sup>)</b>	Good	Average	Poor

Source: Authors

**INFRA  
BONDS?**

**LEAD  
INVESTOR?**

**MDB?**

# Examples – Seychelles / Fiji

## Seychelles

- Large SWF – limited investment opportunities on islands
- Concentrated in government bonds and bank deposits
- Taken stake in largest private companies (brewery + importer/ insurance company) – then listed on stock exchange
- Additional international investment (ETF cheap / efficient instrument)

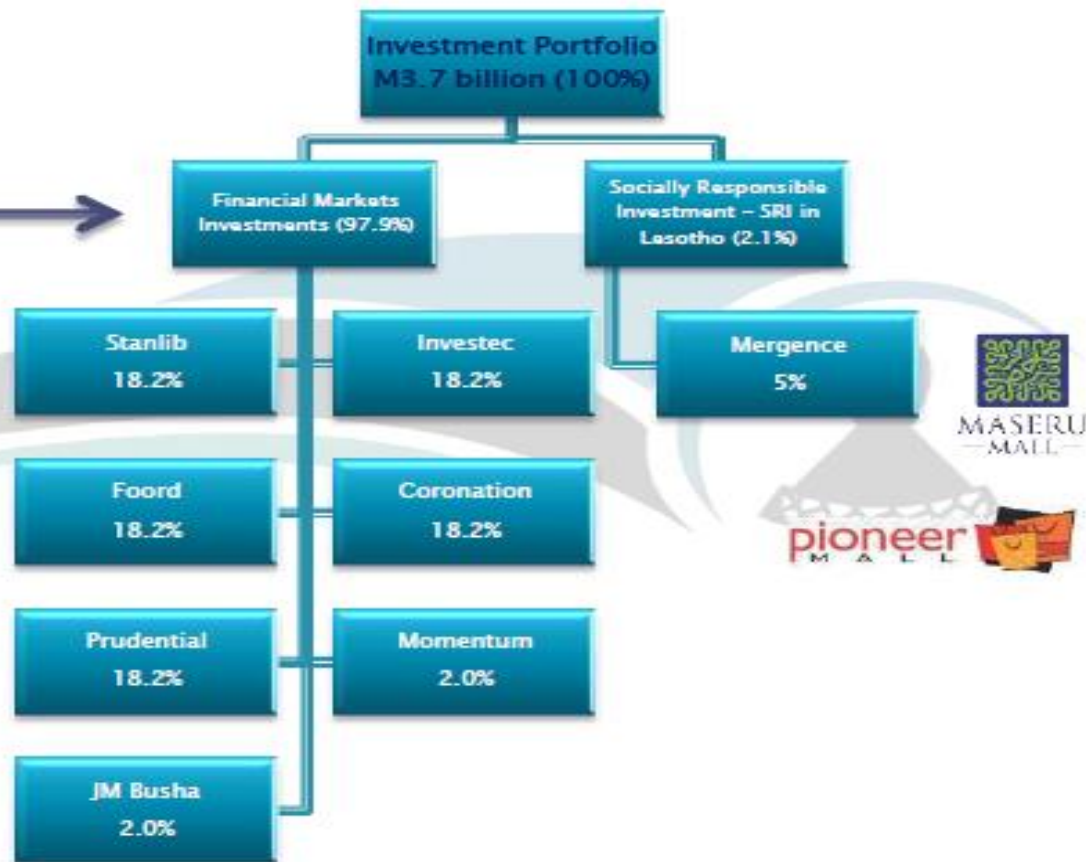
## Fiji

- **FNPF is the largest financial institution in Fiji. It is the only domestic systemically-important financial institution - AUM 50% GDP / 70% of government bond market**
- ***International diversification:* Negotiation with RBF for controlled international investment and appointment of fund managers in preferred markets**
- ***Domestic diversification:* Establishment of subsidiary Home Finance Corporation (foreign owned banks do not serve domestic housing demand well)**
- **Negotiation with Treasury and RBF to issue longer dated infrastructure bonds**

# Examples - Lesotho

(Investment Environment continued)

Spread Investment in traditional Financial market instruments in stock exchanges. i.e. Cash, equities and debt securities.





# Examples - Lesotho

*(Investment Environment continued)*

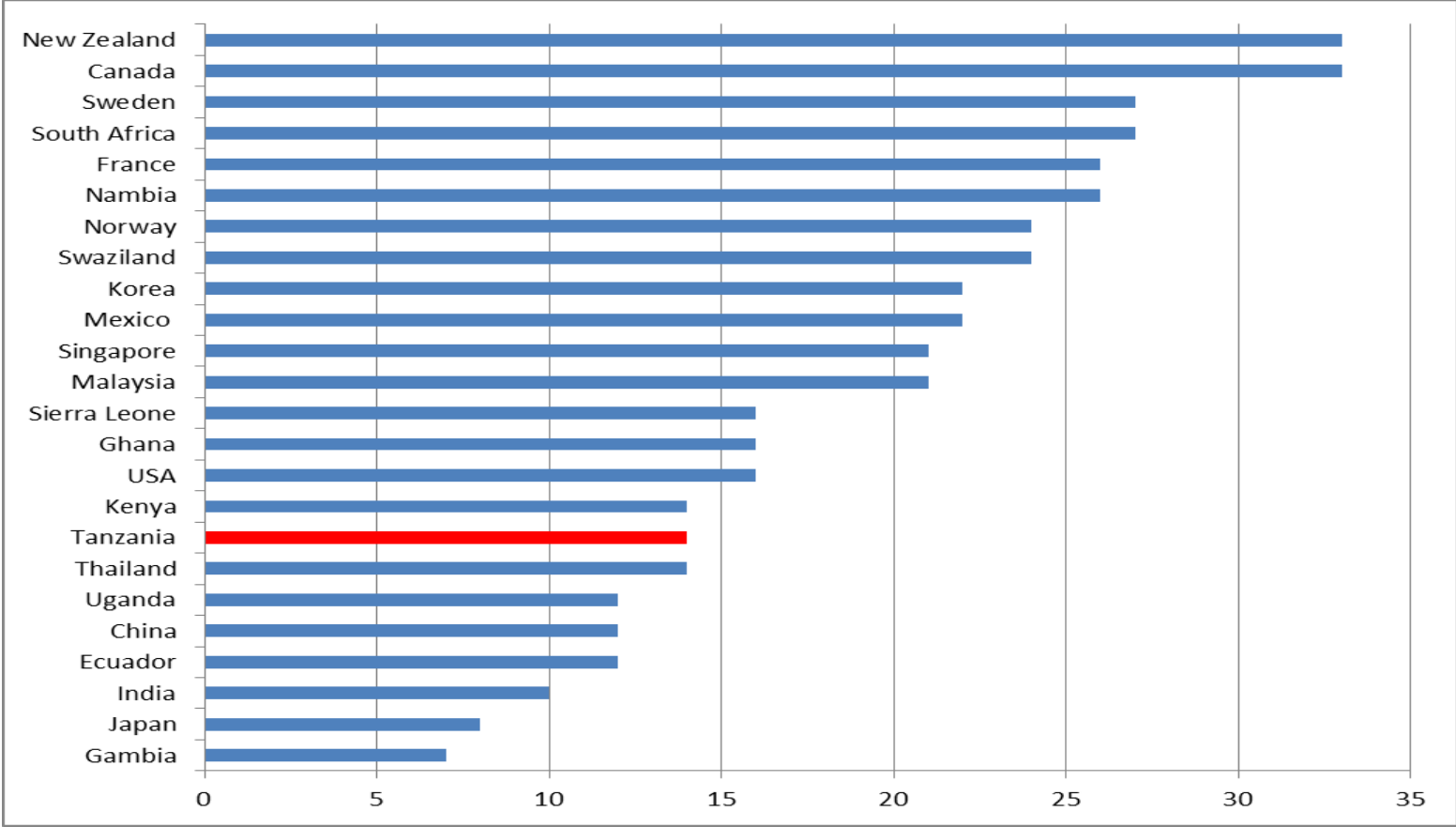
## Focus Areas of the SRI Portfolio:

1. **Property** - Involves share acquisition or development of commercial property
2. **Housing** - Individual ownership preferably under a housing development
3. **Private Equity/SMME** - Empowerment of rights in shares (feasible projects)
4. **AEI Funds** - Includes agriculture, energy & infrastructure (high capital)

The Fund seeks to investigate and look further into formulation **Education and Health Funds**.

Maseru Mall and Pioneer Mall are categorized under **Property Portfolio** category and hence a diversified property portfolio under the approved SRI portfolio.

# Transparency and Governance Index



Source: Musalem and Souto (2010)