INVESTING PENSION ASSETS IN LIMITED CAPITAL MARKETS
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
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**

Source: RBA
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:

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<td>Structured Securities:  CKDs (Mexican Private Equity) y FIBRAS (Mexican REITs)</td>
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</tbody>
</table>

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

- Federal Government Public Debt
- Basic SIEFORES

4,846 days
2,841 days


Participation in Government Securities in the Pension Funds portfolios

Dec 09 66.34%  Dec 12 53.96%  Apr 13 53.22%
<table>
<thead>
<tr>
<th>Institutional Investors</th>
<th>AuM USD</th>
<th>Current Investment in Infrastructure</th>
<th>Asset Allocation Scenario - Infrastructure</th>
<th>Current Investment in EMDE</th>
<th>Potential Investment in EMDE Infrastructure</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>OECD Institutional Investors</td>
<td>USD 80 tn</td>
<td>1% on average implies USD 800bn - mostly in OECD</td>
<td>Increase to 3% (5%) on average implies USD 2.4tn (USD 4tn)</td>
<td>Estimated 10% in EMDE in general - but very small in infrastructure</td>
<td>5% EMDE of 3% in infrastructure = USD 120bn</td>
<td>Limited by both supply (e.g., available projects and assets) and demand factors (capacity, investor regulation, liquidity needs)</td>
</tr>
<tr>
<td>Emerging Market Institutional Investors</td>
<td>USD 5tn</td>
<td>&lt; 1% on average - 0.5% would imply USD 25bn</td>
<td>Increase to 3% on average implies USD 150bn</td>
<td>High percentage in EMDE</td>
<td>80% EMDE of 3% = USD 120bn</td>
<td>Growth potential – e.g., EM pension funds currently $2.5 trillion AUM estimated to rise to USD 17tn by 2050</td>
</tr>
<tr>
<td>Of which: EMDE PPRFs/SSFs</td>
<td>USD 1tn</td>
<td>Limited - some examples - up to 10%</td>
<td>Increase to 5% implies USD 50bn</td>
<td>High percentage in EMDE</td>
<td>70% of 5% assets = USD 35bn</td>
<td>High targets - often the largest source of capital in a developing country</td>
</tr>
<tr>
<td>Sovereign Wealth Funds</td>
<td>USD 4tn</td>
<td>Unclear - 2% implies USD 80bn</td>
<td>Increase to 5% implies USD 200bn</td>
<td>Relatively high in EMDE</td>
<td>30% EMDE of 3% in infra = USD 36bn</td>
<td>Many new EM SWF being set up to specifically invest in domestic infrastructure</td>
</tr>
<tr>
<td>Other global institutional capital (asset/wealth managers)</td>
<td>USD 20tn</td>
<td>Assumed 1% on average implies USD 200bn</td>
<td>Increase to 3% on average implies USD 600bn</td>
<td>Very small in EMDE</td>
<td>10% EMDE of 3% in infrastructure = USD 60bn</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>USD 350 - 700bn</td>
<td></td>
</tr>
<tr>
<td>Annual flows</td>
<td>(over 10 years)</td>
<td></td>
<td></td>
<td></td>
<td>USD 30 - 60bn</td>
<td></td>
</tr>
</tbody>
</table>
### 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**
### 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

<table>
<thead>
<tr>
<th>Country A</th>
<th>Country B</th>
<th>Country C</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sovereign credit rating</td>
<td>At / close to investment grade</td>
<td>Below investment grade</td>
</tr>
<tr>
<td>Size of pension fund AUM (% GDP)</td>
<td>&gt; 10%</td>
<td>1-5%</td>
</tr>
<tr>
<td>Number of pension funds</td>
<td>10s or 100s</td>
<td>A few main funds</td>
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<tr>
<td>Quality of pension system (e.g., Mercer Global Pensions Index)</td>
<td>D</td>
<td>C</td>
</tr>
<tr>
<td>Insurance penetration (% GDP)</td>
<td>High</td>
<td>Medium</td>
</tr>
<tr>
<td>SWF</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Development Fund or Bank</td>
<td>Yes</td>
<td>No</td>
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<tr>
<td>Level financial sector</td>
<td>Medium</td>
<td>Low</td>
</tr>
<tr>
<td>- Bank assets (% GDP)</td>
<td>Medium</td>
<td>Low</td>
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<tr>
<td>- Private credit (% GDP)</td>
<td>Medium</td>
<td>Low</td>
</tr>
<tr>
<td>Level capital market</td>
<td>High</td>
<td>Medium</td>
</tr>
<tr>
<td>- Stock market cap (% GDP)</td>
<td>High</td>
<td>Medium</td>
</tr>
<tr>
<td>Business conditions (e.g., IFC Doing Business ranking)</td>
<td>Good</td>
<td>Average</td>
</tr>
<tr>
<td>Infrastructure investment conditions (e.g., EC Harris Global Infrastructure Investment Index, or Nabarro Infrastructure Index25)</td>
<td>Good</td>
<td>Average</td>
</tr>
</tbody>
</table>

**Source:** Authors

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**Questions:**
- 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

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

Investment Portfolio
M3.7 billion (100%)

Financial Markets Investments (97.9%)
- Stanlib 18.2%
- Investec 18.2%
- Foord 18.2%
- Coronation 18.2%
- Prudential 18.2%
- JM Busha 2.0%

Socially Responsible Investment – SRI in Lesotho (2.1%)
- Mergence 5%
- Momentum 2.0%
Examples - Lesotho

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)