



## CONCEPT NOTE

### **NEPAD 5% Agenda: Mobilizing Domestic Pension and Sovereign Wealth Fund Capital for PIDA and other African Infrastructure Projects**

At the 18<sup>th</sup> ordinary African Union (AU) Summit in Addis Ababa, Ethiopia in January 2012, the African Heads of State and Government adopted **PIDA**, the **P**rogramme for **I**nfrastructure **D**evelopment in **A**frica. *The PIDA Priority Action Plan (PIDA-PAP)* comprises 51 cross-border infrastructure programmes consisting of more than 400 actionable projects in four sectors, energy, transport, trans-boundary water and ICT to be implemented until 2020 (For further information on PIDA, see [www.au-pida.org](http://www.au-pida.org)).

Global consensus on the imperative of addressing the large finance deficit for PIDA-PAP implementation and infrastructure development in general in Africa is well documented. This is clear in the variety of academic literature on the topic, as well as the many high-level policy forums at the United Nations, World Bank, International Monetary Fund, the Organization for Economic Cooperation and Development (OECD), the G-20 initiative on “Compacts with Africa”, the African Union and many others.

As stressed by the Dakar Financing Summit (DFS) in 2014, an increased form of collaborative public-private initiatives is necessary to mobilize risk capital that accelerates PIDA project implementation. Accordingly, the NEPAD Agency was mandated by the DFS to increase and coordinate the private sector participation in PIDA projects through the establishment of the PIDA Continental Business Network (CBN). The CBN is a NEPAD and AU initiative that enables private sector members to communicate recommendations to high-level African policy makers on how to improve the investment climate for infrastructure. Furthermore, PIDA projects are marketed to the CBN for increased private sector involvement in project preparation and implementation. This process aims to promote PIDA projects that are bankable to the private sector and thus, qualify for private finance.

The German Government via GIZ has supported NEPAD in the launch of the CBN and the marketing of PIDA projects. Germany as the current Chair of G-20 is also spearheading the initiative on “Compacts with Africa” to increase investment in African infrastructure. One of the key recommendations of this initiative is to unlock institutional investment from pension and sovereign wealth funds for infrastructure development in Africa.

With global regulatory regimes shifting and diminishing the ability of traditional capital to be invested in assets in Africa, institutional investors in the form of pension and sovereign wealth funds (SWF), have emerged as a potentially ideal financing source to close the estimated USD 68 billion infrastructure finance gap in Africa. Thus, the declared public objective is to mobilize institutional investors to finance infrastructure projects, which are foundational to sustainable and inclusive development on the continent. Against this background, the PIDA CBN in its last report on de-risking large-scale infrastructure projects in Africa recommended to create an African Pension and Sovereign Wealth Fund Infrastructure Co-Investment Platform.



For pension and SWFs to be able to invest in large-scale infrastructure projects in Africa, a variety of issues need to be addressed to strategically and intentionally facilitate long-term allocations. Chief amongst these matters is the need to reform national and regional regulatory frameworks that guide institutional investment in Africa. Likewise, new capital market products need to be developed that can effectively de-risk credit and hence, allow these African asset owners to allocate finance to African infrastructure as an investable asset class to their portfolio (for further information, please see Annex 1).

Building on the guidance and recommendations of the CBN, NEPAD will initiate a campaign to increase the allocations of African asset owners to African infrastructure from its low base of approximately 1.5% of their assets under management (AUM) to an impactful 5% of AUM.

### **Objective of the 5% Agenda**

The overall objective of this agenda is to develop a concrete and feasible roadmap to increase allocations of African institutional investors to African infrastructure to the declared 5% mark. This roadmap after engagement with key stakeholders, will outline very concrete steps and expected outcomes to notably increase institutional investment in Africa's infrastructure, with a focus on regional/PIDA infrastructure projects as a key mandate of the NEPAD Agency.

The NEPAD Agency will steer a dialogue that convenes key stakeholders responsible for investment allocation decisions (e.g. investment banks, pension funds, SWFs, credit rating agencies, financial policy experts and regulators, policy makers, project owners etc.). These stakeholders will provide input to the above roadmap and shall be convinced to support the implementation of this roadmap.

The roadmap will be the backbone for the official launch of the 5% campaign in New York in September 2017. It is foreseen that the roadmap and the campaign will have the following impact:

- 1. Unlocking notable and measurable pools of needed capital to implement regional and domestic infrastructure projects on the continent.*
- 2. Broadening and deepening the currently very shallow African capital markets, whilst at the same time contributing significantly to regional integration and job creation.*
- 3. Promoting the development of innovative capital market products that are specific to the continent's challenges and potential in regards to infrastructure development.*
- 4. Raising the investment interest of other institutional and non-institutional financiers that so far have been hesitant to include African infrastructure projects as an asset to their investment portfolio based on specific, concrete next steps and project suggestions.*



## **ANNEX 1: BACKGROUND, CONTEXT AND EXISTING RECOMMENDATIONS TO INCREASE INSTITUTIONAL INVESTMENT IN AFRICA<sup>1</sup>**

Infrastructure can represent an innovative and attractive asset class for institutional investors with long-term liabilities. And vice versa, leveraging private capital should help some African countries address their huge private investment gaps in infrastructure, which both require long-term finance and play a decisive role in supporting growth. As banks face additional regulatory challenges in extending long-term project finance and as governments have limited fiscal space, it becomes urgent to unlock additional flows from long-term institutional investors such as insurers, pension funds, and sovereign wealth funds that would complement shorter financing from banks.

Yet institutional investors remain hesitant in investing in Africa. For example, to connect infrastructure projects to investors, there are a number of hurdles to overcome, in order to mitigate real and perceived risks (liquidity, currency, project, political). Investors need the data, relationships, desire and risk tolerance to understand, assess, and monitor any infrastructure portfolio. Beyond project preparation, policy, legal, and regulatory issues need to be addressed to bring in institutional investors outside and within Africa. Public finance is also often required to play a catalytic role.

Furthermore, investors often lack expertise in African markets to assess the various risks and adequately structure transactions. The suitable products or vehicles are often missing, as are the right enhancement solutions. Additionally, the regulatory and institutional framework is insufficient, in a number of markets, for these financial instruments to be developed. Few African banks are truly active and experienced in project finance. Africa only managed to close 158 project finance deals with debt totaling \$59 billion over the decade 2004-2013, which represents only 5 percent of infrastructure investment needs and 12 percent of the actual financial flows.

A coherent and coordinated approach is needed to address these challenges and mobilize institutional investors while limiting their risk exposure. This requires specific policies to reduce risks at source and instruments to mitigate risks. National, sectoral and financial regulations also need reforms to lift impediments to invest in those asset classes.

Many countries place limits on the amounts and composition of foreign investment by pension funds. While preserving prudential standards of solvent pension funds and the transition towards risk-based capital regimes of insurance firms, regulatory hurdles against infrastructure finance assets could be adjusted (suitably accommodating quantitative ceilings on asset classes, approval of new financial instruments, concentration levels, foreign investments, forex exposure, geographies) according to the risk/return profile of asset classes. Some countries already endorsed several policy and

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<sup>1</sup> Sources: The G-20 Compact with Africa – A Joint AfDB, IMF and WBG Report; CBN De-Risking Report.



regulatory guidance on mobilizing private investment, especially through diversified capital market instruments, fixed income securities and equity instruments.

The use of risk mitigation techniques and various funding models are important parts of the recommendations which should remain tailored to country-specific circumstances.

From a global perspective, project finance structures tend to record a low probability of default (and lower loss given default, with a similarly high 80 percent recovery ratio in advanced and emerging economies), when contracts are well structured. Project finance may contractually encompass multiple forms (syndicated loans, bridging facilities, etc.) to be tailored to each case. This requires specialized expertise that many banks even in advanced markets do not have. As seen in another region like Latin America, engaging foreign banks is also critical for knowledge transfer and competition to create a project finance culture among domestic banks.

Tackling the financing gap will not only take place through listed markets but also through unlisted instruments, new instruments like project bonds (as piloted in South Africa) as well infrastructure funds (both equity and debt funds). Strategic investment funds, if well-structured and managed, can also be a powerful tool to mobilize private domestic and international investors, and achieve a high multiplier between public capital and private investment. Some prominent examples of infrastructure finance in Africa could serve as important guidelines for the region. In South Africa, the renewable energy sector has already mobilized around \$12 billion of private sector financing since its 2011 launch. The size of the program, its quality and credibility in domestic and international markets are developing a promising framework to refinance projects in the operation and maintenance phase through capital markets. In Kenya, a robust PPP unit and framework were developed over the last three years, which is bringing to market five demonstration transactions. To complement this effort, a comprehensive financing strategy is being developed to engage institutional investors in some Greenfield projects through hybrid financing solutions. These structures would include joint bank financing in the shorter tenors and pension funds in the longer tenors through debt funds. This model is supported by public and private sector stakeholders, and follows a similar successful structure used in Colombia.

Some preliminary recommendations to increase institutional investment in Africa's infrastructure are as follows:

- Develop institutional investors (insurance companies, sovereign wealth funds, pension funds, social security funds, provident funds, mutual funds) as effective long term investors: e.g. withdrawal, redemption, and valuation and investment rules.
- Improve the regulatory framework of pension funds and insurance companies.
- Work with regulatory authorities to ensure investment regulations support long-term investments: adjust asset class restrictions, allow investing in new asset classes (private equity/unlisted bonds/collective investment schemes) if vetted by the regulatory authorities.
- Adjust risk based solvency and capital charges of insurers to reflect the actual risk of underlying investments.
- Revisit regulations that allow access to funds before retirement (inducing managers to rather invest into short-term liquid assets).



- Adopt structural and parametric reforms to improve the solvency of pension fund systems, as well as the coverage of the population.
  
- Improve the governance of pension funds.
- Improve long-term investment strategies particularly for funds governed by their own Acts as opposed to investment regulations (example of GEPF in South Africa).
- Create partnerships (for boards and fund managers).
- Require pension funds to use professional fund managers.
- Create investment structures for non-listed assets which provide professional management and transparency (e.g. Along the lines of the SPV structures created by regulator in Namibia).
- Align capital markets policy and regulations to support infrastructure finance instruments, through an adjusted disclosure regime; possible hybrid issuance regimes; adequate governance of new vehicles, adequate regulations to promote capital markets products (project bonds, investment funds, listed or not securities (re)financing projects, liquidity facilities, covered bonds, mortgage securitization)
- Introduce de-risking instruments to improve risk-adjusted yields; yet containing the resulting fiscal liabilities, in an environment short of derivative markets, but a high exposure of project finance to construction, forex and regulatory risks. Government can tailor partial guarantees.
- Facilitate data collection on infrastructure investments and loans in Africa, allowing investors and lenders to perform due diligence on projects and model investments and financing.

**END**