Harnessing Local Investors in Emerging Markets: the Example of Local Pension Funds

(The study funded by Government of Norway)

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I. Background & summary

Gap in Financing Sustainable Development

- Significant global gap in financing sustainable development
- Over $4T needed annually (OECD estimate)
- Where are the assets?
- Over 80% held in OECD countries and much of the funding will need to come from these countries
- However – there are local entities that can also play a critical role

EMDE development would benefit from local funding

- Funding from developed markets to emerging market economies is typically unreliable when it is needed most
- Local-currency debt funding helps to address the risk of destabilizing currency mismatches
- Emerging market pension funds have $2T in assets and are strong sources of funding
- Often better knowledge of local context and risks
- Their long-term perspective and tolerance for illiquidity makes them ideal sources of funding

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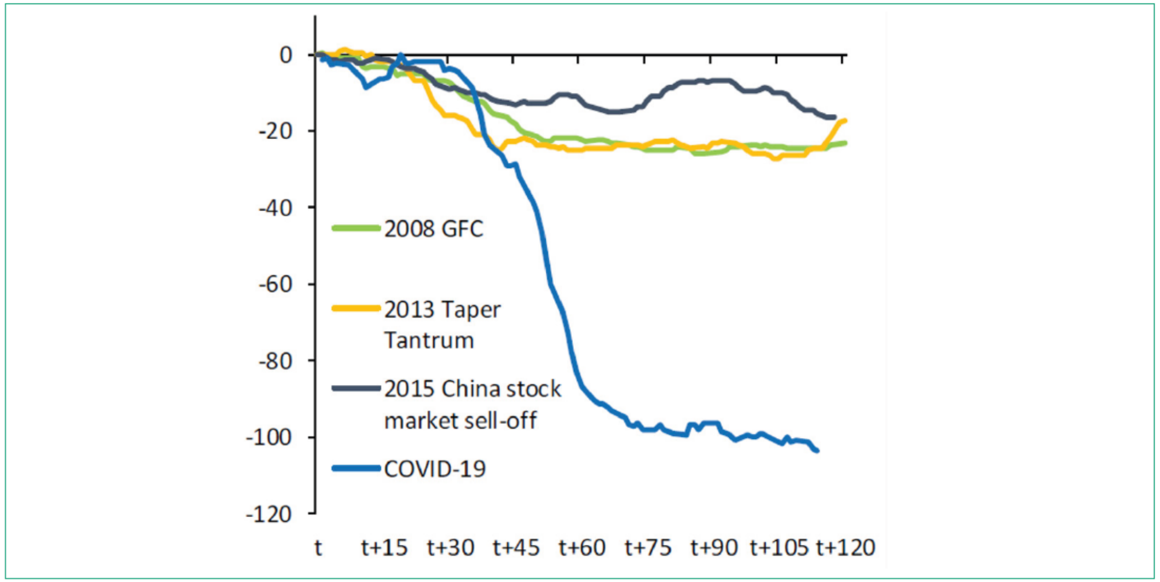
Figure 1: Portfolio Flows to EMEs (2008-2023) (US$ billion)



Source: OECD (2020:3), citing in turn Jonathan Fortun, Daily capital flows tracker. ©2020 Institute of International Finance, Inc, All rights reserved

Note: Cumulative non-resident portfolio flows to Emerging Market Economies since event start date (t for Global Finance Crisis=9/8/2008; for Taper Tantrum=5/17/2013; for China sell-off=7/26/2015; for COVID=1/21/2020)

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Key Preconditions for Local Investors

- Despite advantages, hurdles remain
- Primary mission of a pension fund
  - **Sufficient return to pay beneficiaries based upon nature of liabilities as primary objective**
  - Pension funds ≠ Development Banks

  - Yet both the pursuit of optimal returns as well as development goals can be pursued in tandem so long as priorities are clear.
  - In fact, evidence shows that the pursuit of capital market development in particular can be advantageous to local investors such as pension funds as it increases the diversity of available investment options

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II. Governance

Strong governance is a key pre-requisite for portfolio diversification

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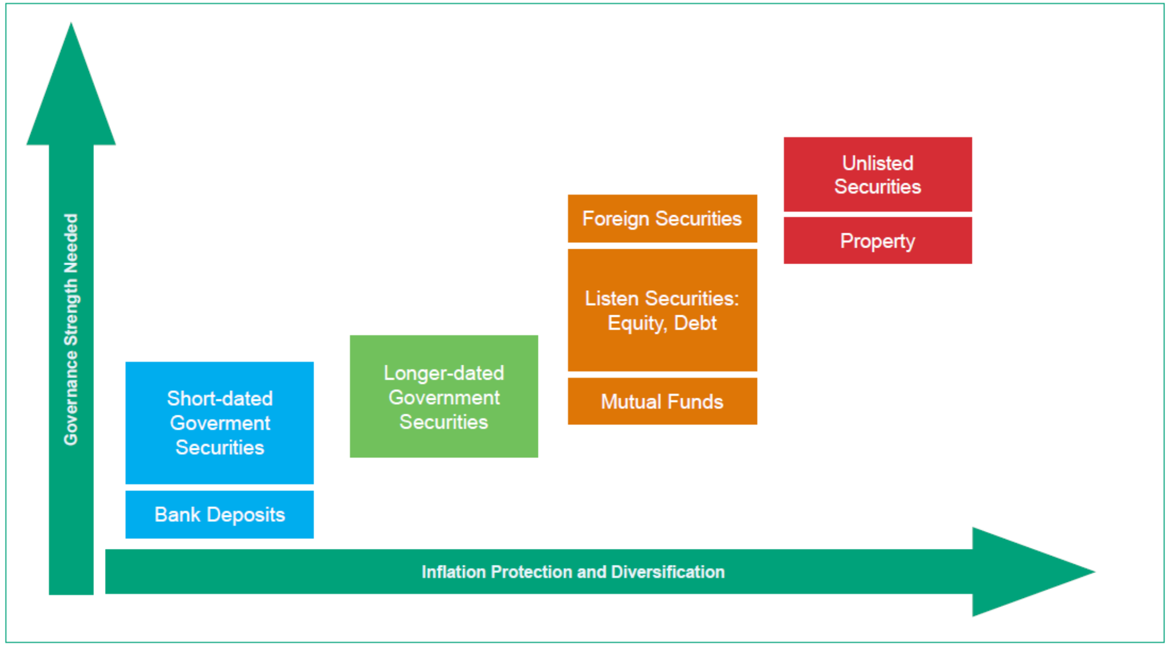
Figure 3: Investment Vehicle Choices depend on Governance capacity



Source: Guven and others (2021), p. 73.

- Typically related to increased duration and complexity, strong governance leads to improved diversification
- It can also support the development of a pipeline of opportunities
- Requires "capable trustees with financial expertise and minimal political interference" to be done well

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Strong governance is a key pre-requisite for portfolio diversification

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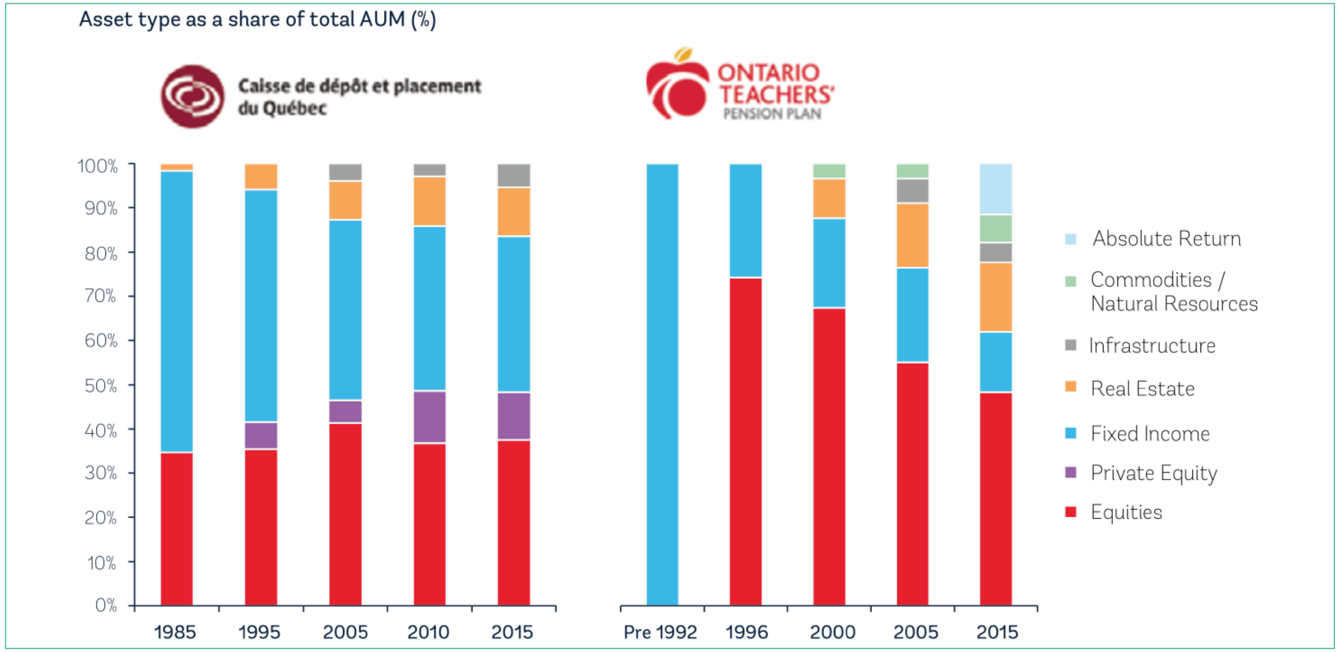
Figure 4: Increasing Diversification of Canadian Pension Fund Asset Mix



Source: World Bank (2017), page 53.

Canadian Pension Funds started with largely government bond portfolios, but drove significant progress in the 1980s and 1990s, resulting in:

- Diversification of investment
- Ongoing evaluation and improvement of the governance model
- Innovation in infrastructure investment

Other large funds have followed this example.

Note the importance of sound sequencing of reforms, along the lines of the Social Insurance Administrative Diagnostic

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Strong governance is a key pre-requisite for portfolio diversification

Malaysian Employees Provident Fund:

- Assets $211bn, 60% of GDP
- Traditional investment objective currently under expansion
- Illustrates both sides of the capital market development symbiosis
- Supported by strong governance and operational excellence
- Good returns delivered
- Increased commitment to sustainable investment and ESG objectives

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Table 1: Asset Allocation, end-2018 (or nearest available date

	India EPF	Indonesia JHT	Malaysia EPF
Year of establishment	1952	1992	1951
Assets relative to GDP	2%	3%	56%
Coverage relative to employment	9%	12%	50%
Asset allocation			
Government debt	**79%**	**63%**	**28%**
Non-government debt	8%	0%	22%
Deposits	9%	9%	6%
Equities	4%	27%	39%
Property, infrastructure and other investments	0%	1%	5%
Memo: foreign investment	0%	0%	27%

Source: Jackson and Inglis (2021), pages 2, 7 and 15.
Note: Assets relative to GDP in India are for March 2018. The asset allocation data for India and Indonesia are for the end of 2017. The government debt figure for Indonesia includes non-government debt.

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III. Pooling

Pension entities are combining their expertise and purchasing power

Several emerging market examples:

- South African Asset Owners Forum
- Kenya Pension Funds Investment Consortium
- Pacific Islands Investment Forum: 18 funds, 12 countries, $8bn assets

Kenya Pension Funds Investment® CONSORTIUM

Pacific Islands INVESTMENT FORUM

ASSET OWNERS FORUM South Africa Convened by Batseta

Key considerations for pooling structures

A continuum of possible approaches ranging from a simple information and collaboration platform all the way to co-ownership of a listed company that undertakes a full range of investment activities

These entities could also partner with international financial institutions (IFIs):

- Local investors provide deployment knowledge
- IFIs bring expertise and underpinning guarantees

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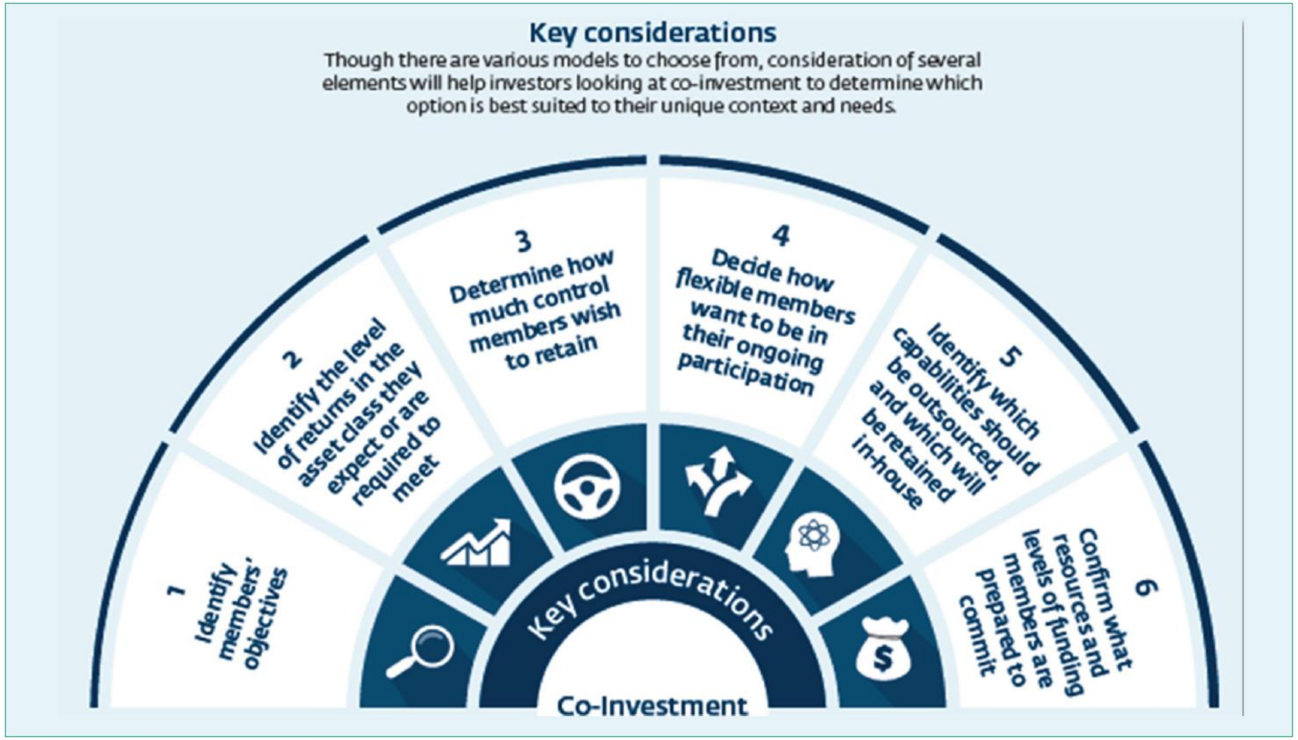
Figure 7: Factors to Consider with Co-investment Models



Source: IFC (2021).

IV. Investment Alternatives

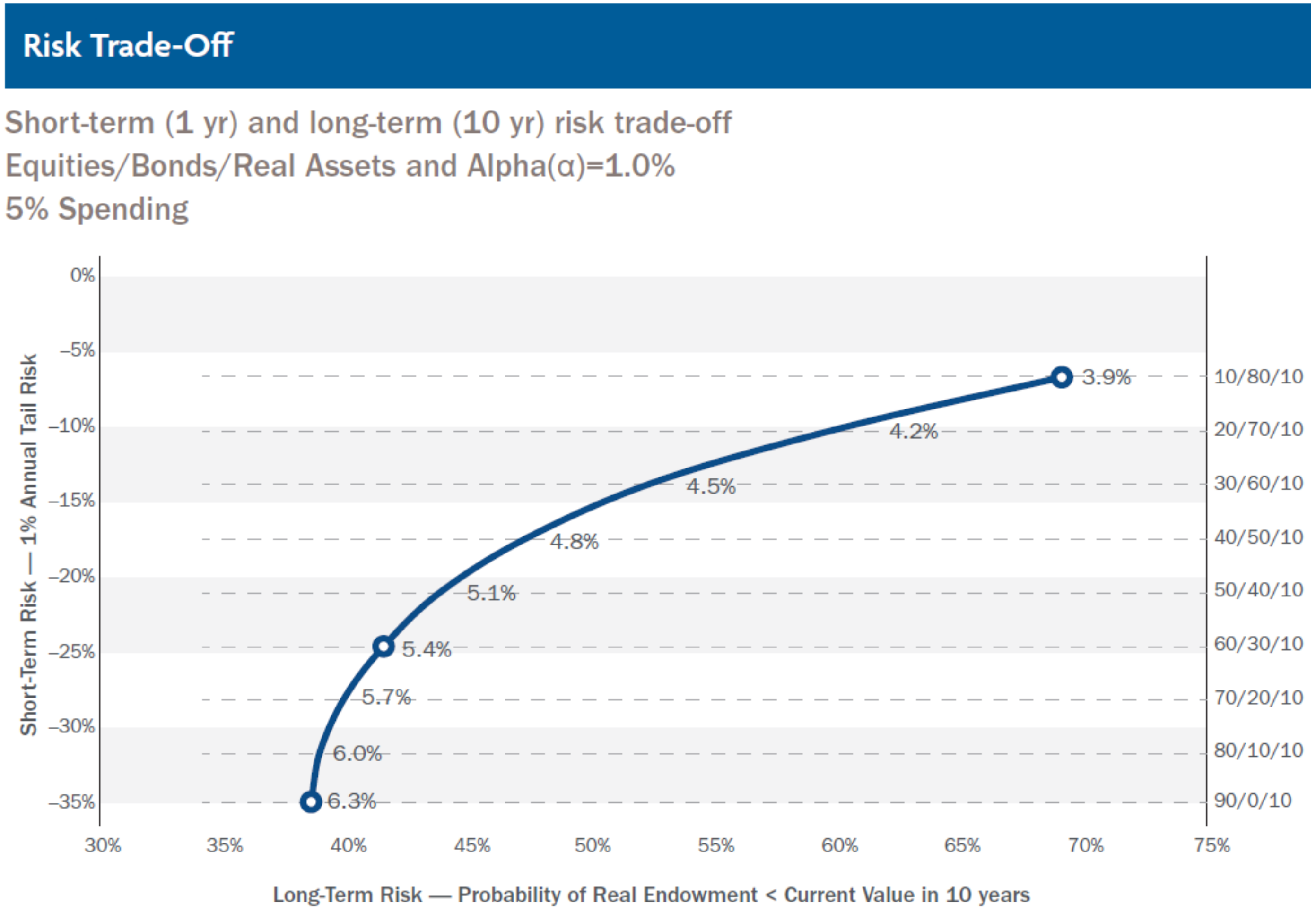
Why consider Investment Alternatives?

Pension funds uniquely able to be patient, long-term investors and 'Shortfall Risk' is critical

Shortfall risk refers to the probability that a portfolio will be below the minimum required return level (target return; benchmark return).

Shortfall-risk is focused on the real economic risk of a portfolio, also known as downside risk. Standard deviation, on the other hand, is a measure of the volatility of an asset.

Pension funds facing increased shortfall risk will necessarily face **risk of increased contributions** from employers and savers to remain solvent.



Source: TIAA Endowment and Philanthropic Services

Investment Alternatives for consideration in the region

1. Infrastructure Debt and Equity
2. Private Equity and Venture Capital
3. Real Estate Investment Trusts
4. Regional Corporate Bonds

Infrastructure Debt & Equity

Global Perspective

- Listed Infrastructure (Equity) Index – Dow Jones Brookfield Global Infrastructure Index; average annual returns ~7-9%, volatility lower than other equity, higher than bonds
- Unlisted infrastructure funds – slightly higher returns but with illiquidity concerns

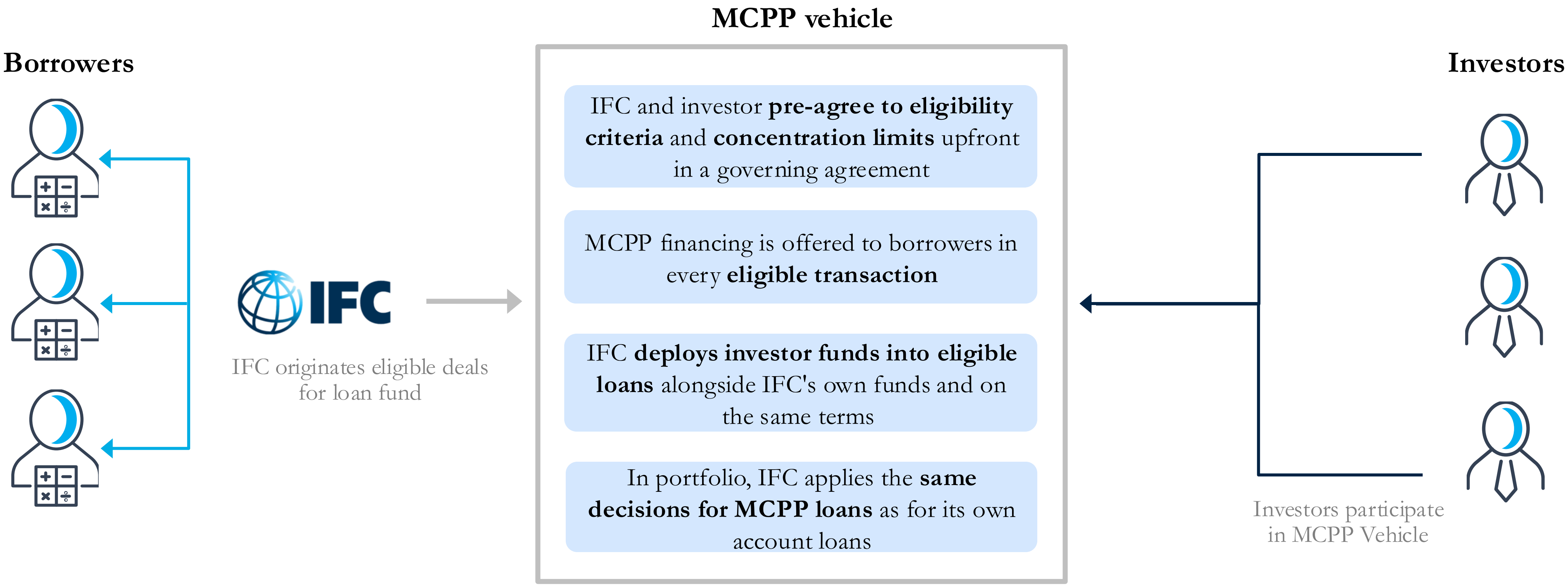
Africa – a growing asset class with various interesting approaches

AFRICA50

Africa Finance Corporation

Global Example: IFC Managed Co-Lending Portfolio Program (MCPP)

Infrastructure Debt – Pension funds participate in "B-Loan" tranche

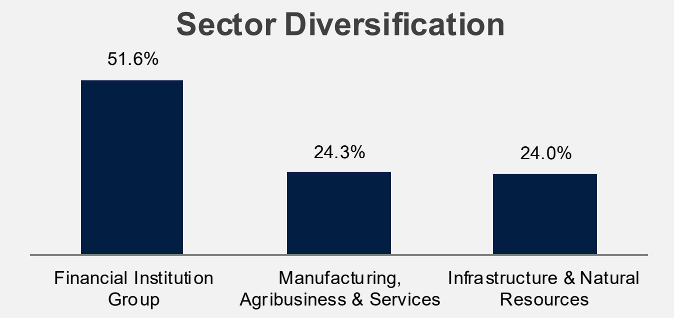


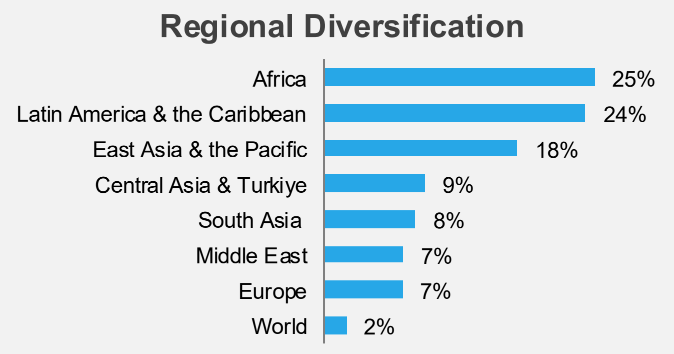
IFC Managed Co-Lending Portfolio Program (MCPP)

- As of December 31st, 2024, **$13 billion** of the total $19 billion MCPP funds pledged has been mandated and committed to **337 projects across 70 countries** – diversified across all regions and sectors.

MCPP Country Diversification

MCPP Regional & Sector Diversification





Note: Reflects MCPP mandated and commitment data as of December 31st, 2024

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Private Equity and Venture Capital

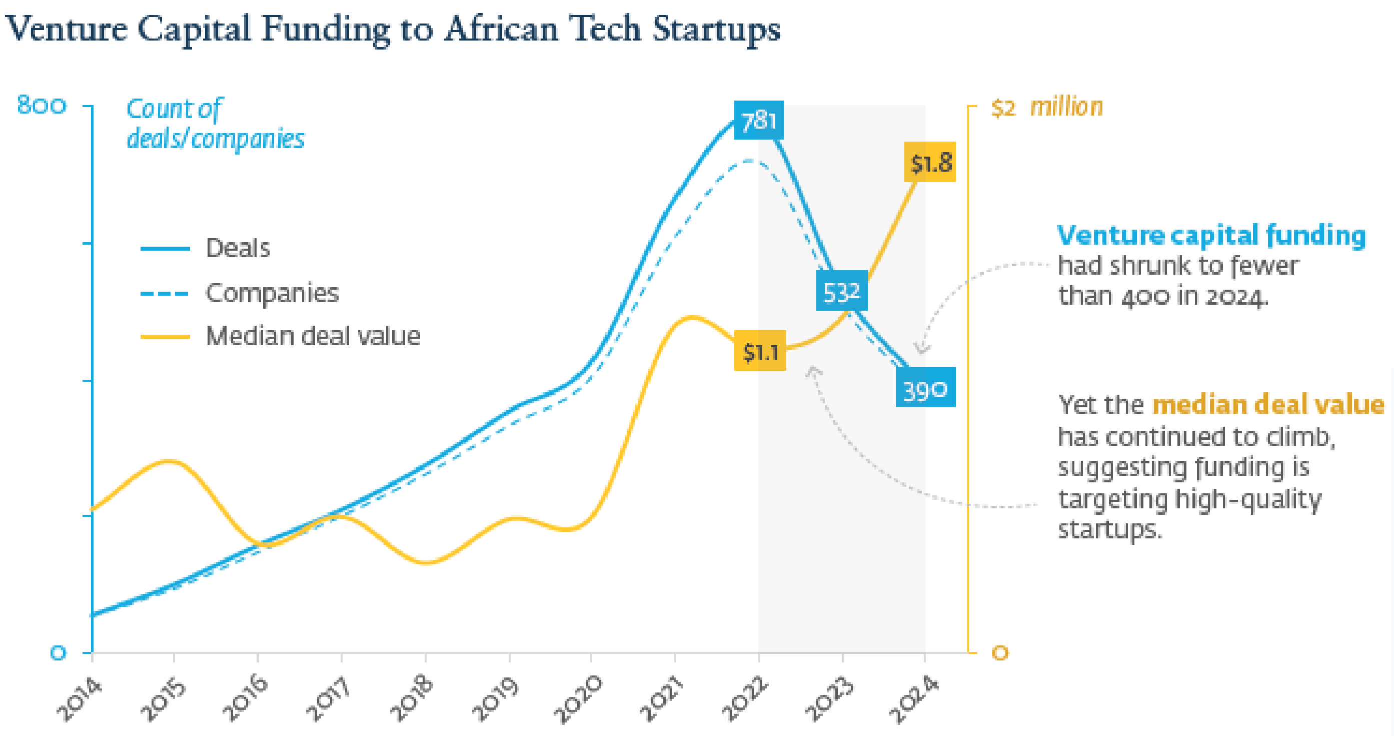
Global Perspective

- PE – Global Buyout Funds – ~11-14% (net of fees) but cyclicality and manager-dependent results, volatility seemingly low but due primarily to infrequent valuation cycle given high risk level of investment
- Venture Capital – ~10-13% but very high dispersion of results

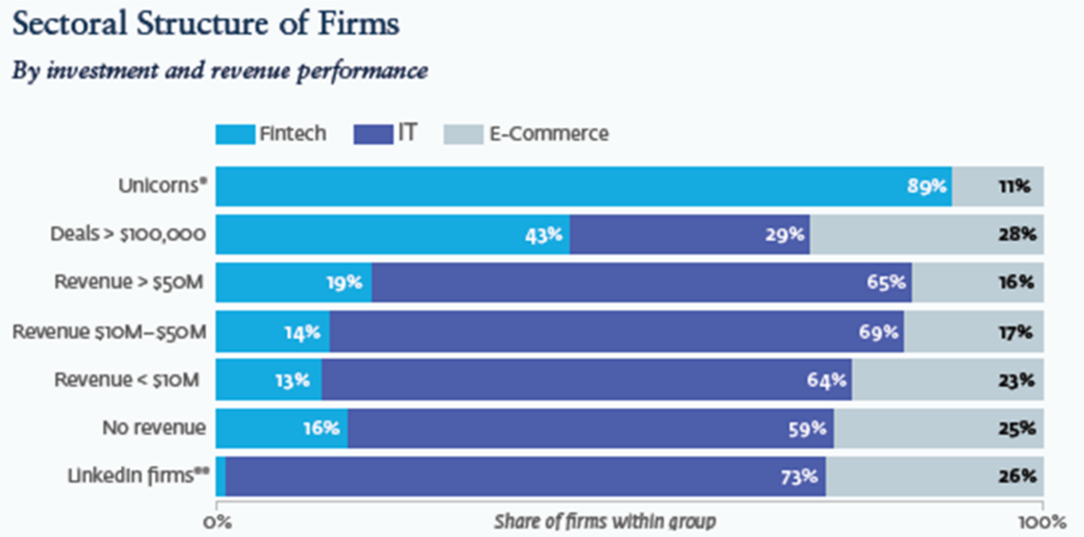
Africa -

PE and VC deal counts declined in 2023, with PE rebounding in 2024. VC deal counts have remained at a more challenging level.

Venture Capital funding trends and nature of investee companies



Source: Pitchbook, 2025



*Unicorns are companies less than 10 years old, valued at $1 billion or more.

**LinkedIn firms refer to all startups not found in VC data but with a presence on LinkedIn.

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Source: IFC (2025) Venture Capital and the Rise of Africa's Tech Startups

REITs and Corporate Bonds

Global Perspective

- REIT long term annualized returns ~8-10% globally, with moderate to high volatility; can move with equities
- Corporate Bonds ~4-5% long-term returns, volatility 5-7%. High yield returns and risk higher.

Africa –

Limited REIT market size thus far, with exception of South Africa

Corporate Bonds – South Africa again leads, but with activity in Nigeria, Kenya, Morocco and Egypt. WAEMU best example of regional corporate bond market

V. Concluding comments

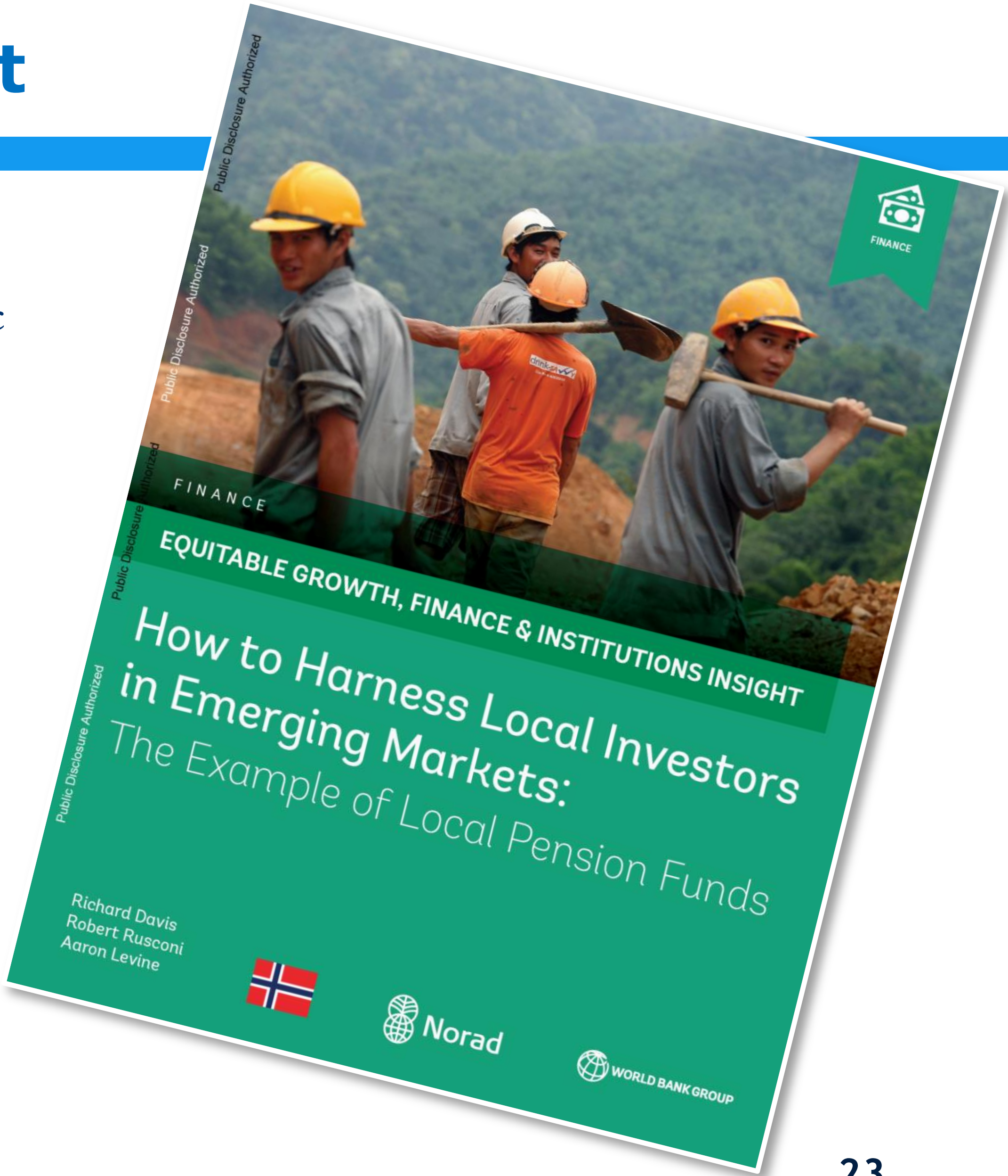
Local investors driving local development

Several examples of local entities supporting emerging market economic growth and development are presented. The demand for and supply of such opportunities can emerge together, led by clear objectives and strong governance, and supported by pooling.

Several factors contribute to the potential for success:

- Governance
- Clarity of Objectives
- Measurement
- Cooperation

Several sources of finance outside of pension funds offer the potential to grow the range of sources of such demand



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