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How to Harness Local Investors in Emerging Markets:

The Example of Local Pension Funds

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Acronyms

APY	Atal Pension Yojana (India)
B-BBEE	Broad-based Black Economic Empowerment
CDPQ	Caisse de dépôt et placement du Québec
CRISA	Code for Responsible Investing in South Africa
DCP	Development Capital Portfolio (Namibia)
EDGE	Excellence in Design for Greater Efficiencies
EMDE	Emerging Market and Developing Economies
EME	Emerging Market Economy
EPF	Employees Provident Fund (Malaysia)
ESG	Environmental, Social, and Governance
GBI-EM	Global Bond Index - Emerging Markets
GDP	Gross Domestic Product
GEPF	Government Employees Pension Fund (South Africa)
GFC	Global Financial Crisis
GIPF	Government Institutions Pension Fund (Namibia)
IFC	International Finance Corporation
IFI	International Financial Institution
IHS	International Housing Solutions Fund (South Africa)
IMF	International Monetary Fund
J-CAP	Joint Capital Market Program
KEPFIC	Kenya Pension Funds Investment Consortium

Acronyms

LPF	Large Pension Fund
NPS	National Pension System (India)
NSSF	National Social Security Scheme (Uganda)
OECD	Organisation for Economic Co-operation and Development
PFRDA	Pension Fund Regulatory and Development Authority (India)
PIC	Public Investment Corporation (South Africa)
PPP	Public-Private Partnership
PPRF	Public Pension Reserve Funds
SACCO	Savings and Credit Cooperative Societies
SDG	Sustainable Development Goal
SME	Small and Medium Enterprise
SSNIT	Social Security and National Insurance Trust (Ghana)
TT	Taper Tantrum
UN PRI	United Nations Principle of Responsible Investment
US	United States
USAID	United States Agency for International Development

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[1]. J-CAP's in-country work is made possible by the support from the Governments of Australia, Germany, Japan, the Netherlands, Norway, and Switzerland. The Governments of Luxembourg and Norway support J-CAP's related knowledge work.

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Executive Summary

There is a significant gap in financing sustainable development in emerging economies to meet the climate commitments under the Paris Agreement and to fulfill the Sustainable Development Goals (SDGs). The Organization for Economic Co-operation and Development (OECD) estimates that more than US$4 trillion of financing is needed annually. While much of the capital required will come from OECD-country sources, which hold 80% of worldwide financial assets, there is an untapped pool of local investments to be drawn on.

Local investor sources can offer a range of benefits. Local investors, such as pension funds, which are the primary focus of this paper, hold over US$2 trillion (OECD 2021, citing size of non-OECD pension funds) in assets and have a long-term investment horizon, a local currency focus, and the local knowledge which can complement foreign capital sources. As seen in the COVID crisis, they are also a steady source of capital. In many cases, these investors have the potential to be long-term, patient investors, which is ideal for financing long-term sustainable investment projects.

If even a small proportion of those assets were employed productively in infrastructure and small business investment in the pension funds' local economies, they would demonstrate a significant impact. This was evidenced in a recent World Bank paper,[i] which looked at four decades of research and indicated that investment in digital, power and transport infrastructure consistently led to improved growth and development outcomes. The involvement of large local institutional investors such as pension funds also creates increased demand for local investment instruments such as bonds, which in turn further develop local capital markets, leading to potential further investment. Local investment also ensures the benefits flow back to local beneficiaries both in terms of financial returns and the development impact of the funded project.

However, these prospective local investors must address several challenges to realize their investment potential. First, they must properly prioritize their objectives. Pension

[i] The Impact of Infrastructure on Development Outcomes, World Bank 2023

funds, as the premier example of potential local investors, are often asked to invest disproportionately into local projects intended to fund economic growth. Unfortunately, such projects may sometimes be proposed despite questionable economics if they are politically favored for other reasons. In this situation, it is critical that local pension funds have a stated priority that focuses first on the welfare of pensioners and beneficiaries and second on a complementary goal of growth. Many projects will fulfill both objectives, and the paper focuses on this frequent possibility, but if pensioner welfare is not improved, the project should not go forward.

Secondly, local investors face certain structural barriers. A common issue that many of these entities struggle with is that of inadequate governance. Another area of weakness is their relatively underdeveloped investment capabilities and expertise. Given the nature of the investments needed in emerging economies, the investors may not have the requisite know-how to make well-informed decisions in these areas.

Given these challenges, the paper focuses on three actions to further mobilize local investors toward sustainable development:

1. **Strengthening the governance of local pension funds, including through public policy reform.** Ultimately, investment in sustainable development cannot be effective without this critical precondition being met. Evidence globally indicates that more effective governance leads to improved diversification and more efficient use of assets. Developing effective governance requires moving from a 'pre-reform entity' to one with growing expertise, more independence of decision-making, and increasing levels of competence and expertise. The paper shares the examples of strong public funds in Canada, successful pension fund governance improvements in Namibia, and the progress over time exhibited by the Employee Provident Fund of Malaysia.

2. **Unlocking the potential impact of local investors with innovations such as consortia that pool expertise, capital and enable further diversification.** An emerging example of amplified impact for local investors is the establishment of pension fund consortia within countries or regions, where investment opportunities and comparative knowledge and skills can be shared, and structures can be established that can draw in foreign institutional investors and International Financial Institutions (IFIs). IFIs can also support project structuring and fundraising from global concessional resources in partnership with local investors. The World Bank's support of such investment pooling examples in Africa and across the Pacific Islands are elaborated in the paper.

3. **Growing the pool of potential local investment sources** by revealing opportunities through 'hidden' local investors that may already exist in some emerging markets. **Greater regulatory oversight may be required** for them to invest more efficiently and effectively (for example, the under-regulated pension arrangements in South Asia (Chapter IV)). Both policy support and capacity building are required to cultivate the development of these new sources of domestic capital (for example, supporting savings arrangements for informal-sector workers (Chapter IV)).

The paper offers three practical directions for policymakers in order to make the promise of local investors contributing to sustainable development a reality. While this level of focus will require **concerted effort to implement, it increases the opportunity for local investors to play a crucial role in closing the financing gap.**

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Background, Structure and Definitions

1. The magnitude of additional investment needed in the emerging market and developing economies (EMDE) to meet the Sustainable Development Goals (SDGs) and Paris Accord means that both international and local investment will have to be mobilized. The financing gap to meet the SDGs is estimated to have increased to US$ 4.2 trillion per year following the COVID-19 pandemic (OECD 2020). Given this magnitude of need, it will be necessary for international financing sources to play a large role, as more than 80 percent of financial assets are held in OECD countries (OECD 2020). Yet, there are critical reasons why more investment should also be sourced from the EMDE countries themselves.

2. A key reason why EMDEs should look to source more funding internally is the frequent transitory nature of foreign investment. The COVID-19 crisis is just one recent example illustrating that capital flows from overseas can quickly evaporate during times of stress in international financial markets (see figure 1). Significant withdrawals occurred again in 2022, with more than US$ 50 billion withdrawn from emerging market bond funds in the early part of the year, as United States (US) interest rates continued to rise (Asgari 2022).

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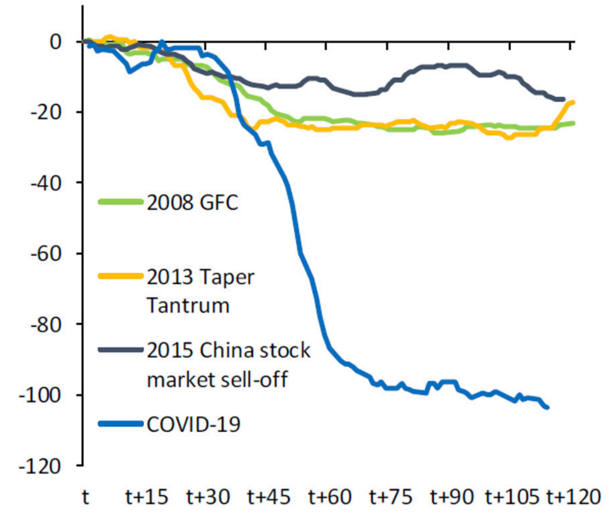
Figure 1: Portfolio Flows to EMEs (2008-2023) (US$ billion)



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)

3. In addition to the overall risk of capital flight, the issuance of additional local currency debt helps to address potentially destabilizing currency mismatches. The financial crises of the 1990s made it clear that currency mismatches in the issuance of debt combined with maturity mismatches made developing economies even more vulnerable to these types of capital outflows (Hofmann and others 2020). Although these economies adapted their fundraising behavior to borrow more predominately in local currency, this has not insulated the emerging market economies (EMEs) from currency movements, especially given sharp currency declines, record portfolio outflows, as well as a spike in local currency bond spreads. Figure 2 illustrates the average of exchange rate changes and impacts to local currency bond spreads over the course of the crisis in the early months of the pandemic in 2020 (Hofmann and others 2020).

Given these realities, it becomes clearer that local, long-term development priorities will need to be met with a balance of international capital and funds from more stable — and if sometimes more expensive — local sources of long-term capital.

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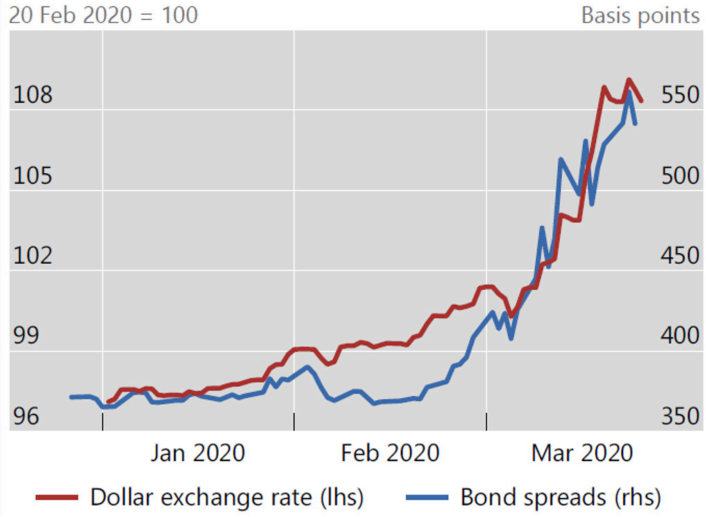
Figure 2: EME to US$ Simple Average (lhs) with EME Spreads (rhs)



Source: Hofmann and others (2020, p. 2).
Note: Exchange rate is the simple average of EME,s excluding China. The increase reflects the US dollar appreciation. Spreads indicate the difference between the yield of Global Bond Index-Emerging Markets (GBI-EM) broad index (for example, China) versus US Treasury yields.

4. Using such local sources of savings to fund sustainable development may be more available in emerging markets than is apparent at first sight. A common assumption is that developing economies do not have such sources of long-term, domestic capital available. For example, the amount of pension savings in many non-OECD countries is typically one of the best sources of long-term sustainable investment, given the maturity of their liability profile. — However, it seems low in absolute terms, at least at first glance. Nonetheless, the amount of pension assets as a percentage of gross domestic product (GDP) are in fact considerable, and are growing quickly. For example, in Peru, it is at 23.1 percent of GDP; in Croatia, at 34.6 percent; and in South Africa, at 92.1 percent (OECD 2021). In addition, OECD data shows that these assets are also growing fast. Indeed, pension savings in non-OECD countries doubled between 2010 and 2020, that is, from US$ 1 trillion to US$ 2 trillion (OECD 2021).

5. This paper makes the case that local investors, especially pension funds, can play a key role in supporting development, while also detailing the necessary steps to enable successful portfolio diversification. For those local sources of capital to be effective, it will be necessary to balance the primary need to pay beneficiaries with the complimentary goal of supporting sustainable economic growth and development. As such, it will require the following: (i) the establishment of strong governance; (ii) a clarification of objectives; (iii) building capacity through co-investment and pooling; and (iv) the cultivation of new and what may otherwise be hidden sources of local investment. Of these four principles, some represent the reiteration of important tenets shared before, but others, especially the examples of pooling and cultivation of somewhat hidden new investment pools, are relatively new. Each of these four principles is illustrated with examples from across the developed and developing markets.

6. Local pension funds are just one of the typical institutional investors that can play a role in developing economies. In addition to pension funds, local insurance companies can also play a large role, especially with regard to their long-term insurance business, for which likely liabilities are well into the future. Local banks are also typically key players. Investment funds may exist locally and have a significant presence. There may also be government, or third-party controlled development finance institutions. Finally, there are several other, smaller entities that may exist in market. The paper discusses a few of these toward the end.

7. In many ways, pension funds form the ideal match for local demand for investment in sustainable development. This paper refers to local sustainable development as investment which contributes to a closing of the investment gaps against the SDGs and Paris Accords. Pension funds are long-term and typically patient in nature. They may have cash ready to deploy and are anxious to avoid asset vs. liability mismatches. Therefore, the case for investment in long duration assets that are expected to improve local prospects, while also delivering competitive returns, is strong. Often the type of investment assets that fit this description involve infrastructure investment, unlisted and relatively illiquid, but with duration hedging characteristics and reliable, predictable and relatively assured cashflows. Again, it is a good fit as these funds have their long-term obligations to beneficiaries denominated in local currency. In fact, many pension funds around the world have established strong track records of enabling this type of development.[1]

8. Yet the provision of local development financing should be carefully balanced with pension funds meeting their liabilities, as well as providing for adequate pensions for their members. The primary mission of a pension fund is to deliver sufficient returns to be able to pay beneficiaries. When funds are instead used to serve effectively as local development banks in a manner which is inconsistent with their primary mission, this can prove to be at a detriment to their returns — ultimately resulting in neither goal being achieved. However, the examples in this paper will show that, in some situations, returns and development goals can be pursued simultaneously, resulting in a win-win situation. Indeed, by no means do investments that contribute to sustainable development necessarily prove to be inferior – in many cases they can equally provide strong return results while delivering preferred outcomes in terms of development.

9. International evidence shows that supporting local capital market development can be consistent with the primary goal of a pension fund to pay beneficiaries, as it helps the diversity of available investments. Evidence exists that capital market development typically goes hand-in-hand with increases in investable assets (Catalan and others 2000; Hu 2005; Kolodiziev and others 2021; Thomas and Spataro 2016; and Vittas 2000; Walker and Lefort 2002). As detailed by Jackson and Inglis (2021), among others, the development of investment markets follows a certain path. It starts with bank deposits, and then government debt of increasing duration. This then grows into loans to other entities and listed shares, and then an expansion into other private investment classes. This sequence represents a reasonable match of the corresponding incremental needs of the private pension funds for asset classes to deliver returns to their members.

10. Regarding the broader goal of supporting local sustainable development, balancing it with the primary mission of paying pension benefits requires more care. Pension fund members cannot be expected to subsidize sustainable investment for their fellow citizens to the detriment of the performance of their fund — even when they can be considered 'universal owners' covering a large percentage of the local population (Unwin 2011). However, where the fund can make a profitable investment in a project that will also aid in local progress, pension fund members in an EMDE context would likely be more open to such dual mandates than those in high- income countries, given their awareness of significant local needs. A particularly helpful body of guidance on balancing these various goals is provided by the International Organisation of Pension Supervisors (IOPS) in their 'Supervisory Guidelines on the Integration of ESG Factors in the Investment and Risk Management of Pension Funds.'

[1] It is important both to note that the conclusions in this paper pertain not only to defined contribution (DC) funds but also to other versions of funded pension vehicles. However, for schemes with fundamental design issues threatening their ability to fulfill their core obligations, those design issues must be addressed first before expansion of their investment mandates is entertained.

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The Critical Role of Strong Governance

11. International experience shows that strong governance is an important pre-requisite for funds to successfully diversify and take advantage of long-term investment opportunities. A scheme with "strong governance, capable trustees with financial expertise and minimal political interference" (Guven and others 2021) typically has a more straightforward path to fruitful diversification than a scheme without these capabilities. Such a scheme is also better positioned to deliver improved inflation protection (as in figure 3), as well as potential secondary objectives, such as those focused on local development. Investment in short-term, fixed-income investments requires little specialist knowledge. However, as funds move into other asset classes, capacity needs to be built. This includes enhanced capacity for trustees overseeing more sophisticated investment strategies, as well as for external managers. This is even more the case with unlisted securities, which place a high demand on fund governance capabilities as a key prerequisite. Indeed, this is where investment opportunities often lie in emerging markets with under-developed, formal capital markets. In-house management of assets by funds likewise requires even greater governance oversight and control.

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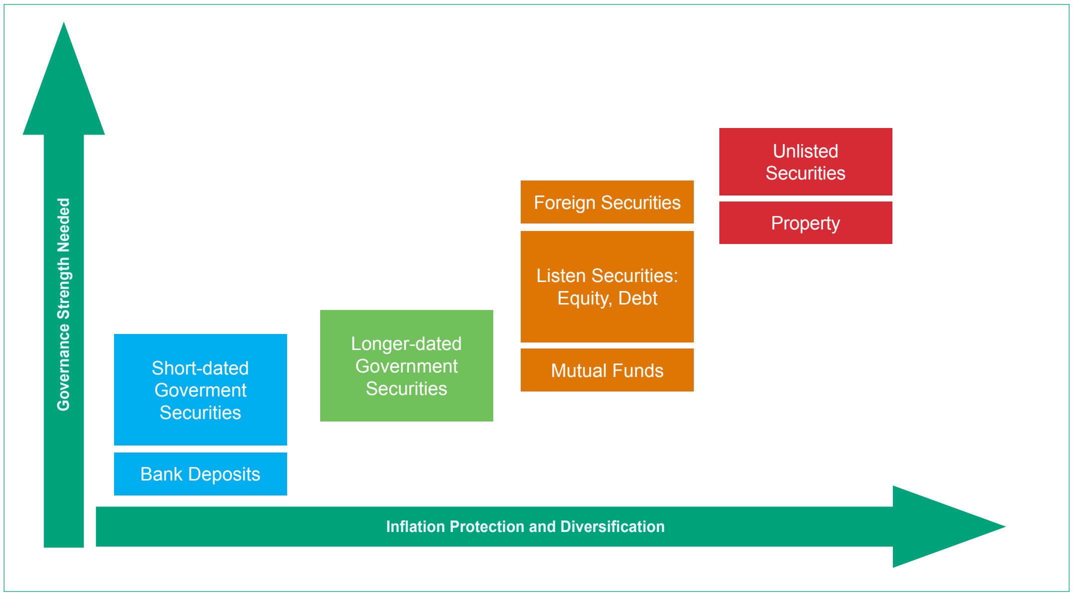
Figure 3: Investment Vehicle Choices depend on Governance capacity


Governance Strength Needed
Short-dated Goverment Securities
Bank Deposits
Longer-dated Government Securities
Foreign Securities
Listen Securities: Equity, Debt
Mutual Funds
Unlisted Securities
Property
Inflation Protection and Diversification

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

12. Pension governance is similar to corporate governance, but with key differences; effective pension governance typically leads to improved investment diversification and more efficient use of assets. According to IOPS[2], pension fund governance refers to the framework by which the governing body makes key decisions about the pension funds' business. It includes the structure of the governing body itself (legally and organizationally); the decision-making processes to include risk management, compliance and oversight; the skills and competency of the governing body; and the means by which the governing body is accountable to stakeholders, both narrowly and more widely defined. A key difference between typical corporate governance and pension governance would be the stakeholders; in the case of a corporate entity, the shareholders would take the pre-eminent role whereas in the case of pension funds it would be plan members and other beneficiaries. There is evidence that high quality pension governance leads to greater investment diversification and lower levels of inefficient cash holdings (Bregnard and Salva 2022).

13. Well-governed funds can also play a role in developing such long-term investment opportunities in markets where a lack of a pipeline investments is often the binding constraint to their diversification. Although this note will focus on highlighting new local investor opportunities, in many cases the key issue may in fact be a lack of suitable investments. Pension funds will often represent a good match for worthy local investment but again the investment instruments suitable for those funds to consider may not exist. In this situation, the building of pension fund governance and investment capability in a wider range of asset classes can be a catalyst for new investment opportunities to be structured that meet their needs. As the international case studies show, well-governed local funds striving to diversify their portfolios and actively signaling a desire to invest in long-term assets on a high quality, fully transparent basis (with appropriate public disclosure) play a key role in driving such investment opportunities to be created which match their risk-return profile.

Canadian Pension Funds

14. Although now seen as leading global examples of diversified investors in long-term, real assets, a lack of asset diversity was an issue for some of the best-known and well-regarded Canadian pension funds in the 1980s. Two of the funds now known for innovative investment approaches (the Caisse de Dépôt et Placement du Québec and the Ontario Teachers' Pension Plan, see figure 4) began their journey with most of their assets invested in government debt instruments. However, in both cases, the funds made significant progress during the 1980s and 1990s, thus significantly diversifying their investments to drive improved returns.

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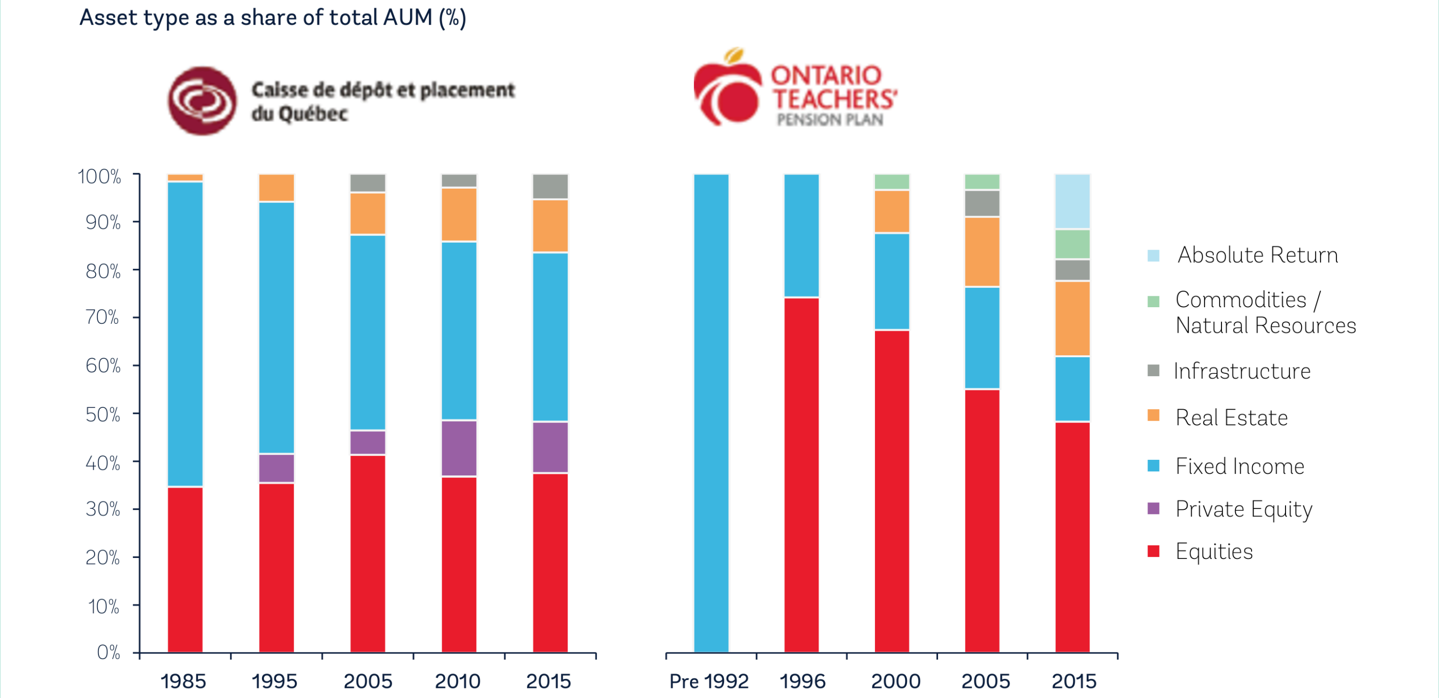
Figure 4: Increasing Diversification of Canadian Pension Fund Asset Mix



Source: World Bank (2017), page 53.

[2] IOPS (2008), 'Supervisory Oversight of Pension Fund Governance' Working Paper Number 8

15. A critical element of the increasing diversification of the Canadian pension funds was the strong evolution of the underlying pension organizations (World Bank 2017). This evolution (see figure 5) demonstrates the critical transition from a pre-reform entity to one with a reliable and robust foundation for decision-making. Ultimately, the funds progressed to become independent, professional entities.[3] As such, they were better equipped to handle increasingly diverse and complex investments in asset classes that were able to deliver secure, diversified investment returns. Indeed, the example provided by the funds in Canada best illustrates the reality, as shown in figure 5, that the development of robust organizational strength and capability is closely linked to the development of strong governance.

16. Beyond simply diversifying their asset portfolios, one of the specific innovations that the Canadian funds has led has been a move toward investing in infrastructure, a particularly helpful asset class in enabling more sustainable development progress. The large Canadian funds are viewed as a role model in this area in terms of how they deal with risk, and how they structure deals. They collectively allocated some 5.2 percent of their assets to infrastructure, the highest rate globally, with some having twice that amount (PwC 2016). The ability to invest wisely in such asset classes requires several preconditions, such as strong governance and organizational culture (World Bank 2017, page XIV)(see also figure 5). Importantly, the Canadian funds largely invest globally in infrastructure, not just in domestic market infrastructure. However, the example they provide in ensuring strong governance first is helpful to show what is needed to implement an innovative and diversified investment approach. As part of this journey, the Canadian funds have also begun to make a significant difference in more environmentally sustainable investment. A recent report analyzing 12 of the large Canadian funds indicates that they collectively have more than US$160 billion invested in environmentally sustainable investments, including renewable energy investments, as well in as green infrastructure and building assets (Smart Prosperity Institute 2021).

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Figure 5: The Four-phase Framework for the Evolution of Pension Organizations

Typical Characteristics

	Pre-reform entity	A solid foundation	Independent, professional entity with strong governance	Mature, sophisticated entity
Governance	• Part of government - no real independence or arm's-length overnight	• Reform strategy in place • Stakeholder buy-in to reform • Earning trust of government and private sector	• Independent governance	• Mature independent governance model
People and organization	• Low expertise or experience in external best practice • Limited procurement skills	• Developing in-house staff • External hires to fill gaps • Developing skills for external sourcing	• Ability to attract qualified professionals • Strong program to develop internal talent	• Ability to attract global top talent • Ability to develop top quality internal expertise
Investment	• Little diversification-sometimes 100% in nonmarketed government debentures and 100% domestic	• Begin to diversify investment • Begin to build investment expertise	• Diversified investments • Increasingly competent in-house investment capabilities	• Highly diversified investments • Sophisticated in-house investment teams
Administration	• Inefficient, and ineffective plan administration • Significant errors • Poor member services	• Major administrative errors corrected • Investment in systems to reduce costs and improve service	• Competent plan administration	• Professional plan administration • Modern technology • Strong client service
Plan design and funding	• Pay-as-you-go or limited funding • Little clarity on liabilities	• Realistic understanding of liabilities • Active dialogue on plan sustainability	• Improved funding • Realistic understanding of assets and liabilities • Sustainable funding target	• Assets and liabilities well balanced • Funding is sustainable
Regulation and public policy	• Outdated or legacy legislation • Strict investment limits • Little political will for reform	• Updated legislation • Some investment freedom	• Modern legislative framework • Limited investment restrictions	• Proactive improvements in legislation and regulation • No investment limits

Source: World Bank (2017), page XIII.

[3] Another type of example of forging strong governance is provided by some social security organizations that fully separate their investment entity from the balance of theinstitution. Jordan's SSIF is one such entity.

17. A review of the investment practices of other large, long-term pension investors around the world indicates an increasing willingness by these investors to follow the lead of the Canadian funds and to diversify beyond simple government debt instruments. The periodic OECD survey of large pension funds shows a trend of continuing diversification into more alternative investments. Within these alternatives, there is an increasing tendency to invest in more challenging, yet more fruitful investments for the purposes of enabling sustainable development, such as unlisted infrastructure (see figure 6). This trend covers pensions funds in other developed countries with low interest rates and deep capital markets (notably, Australia). The trend extends to regions with less deep capital markets (for example, in Latin America and Southeast Asia), as well as from leading funds in other regions (for example, in Southern Africa). Many of the latter are investing in domestic rather than international markets due to regulatory restrictions.

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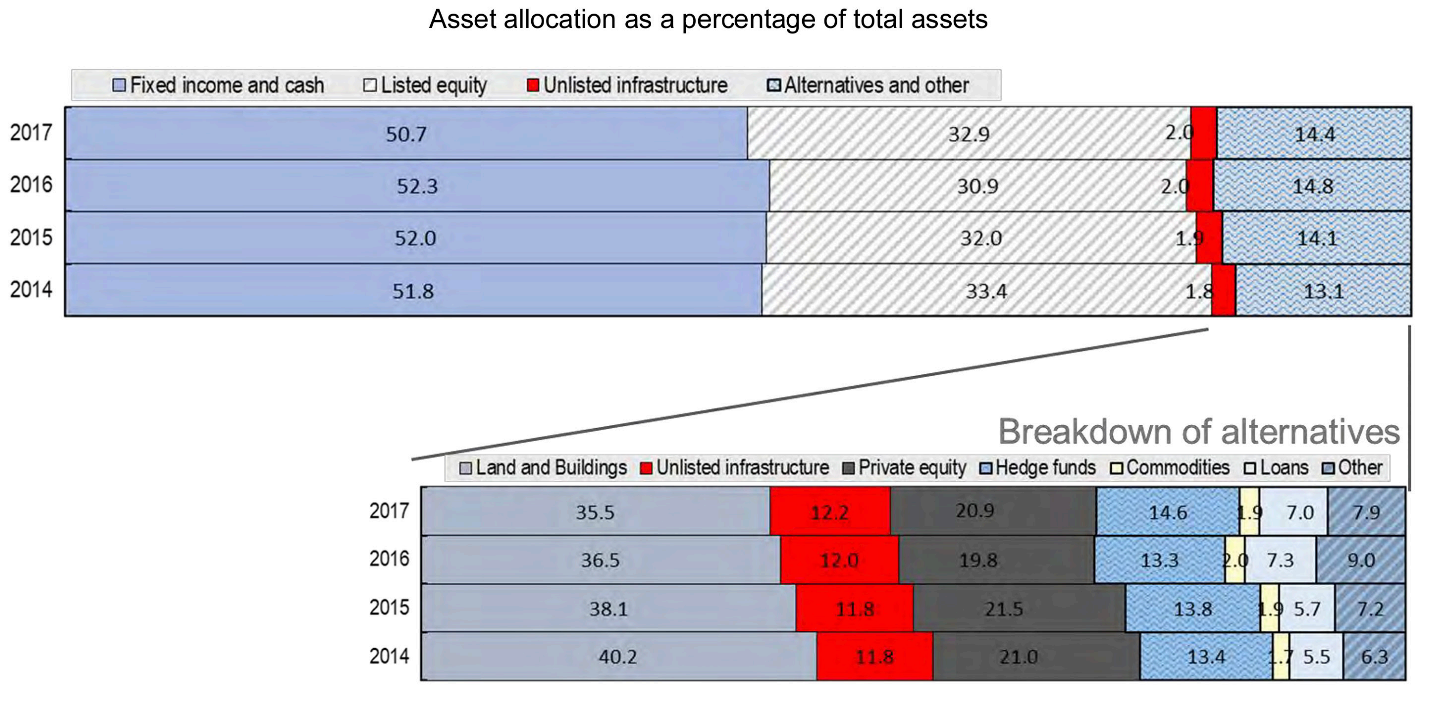
Figure 6: Asset allocation as a percentage of total assets



Note: Values are a simple average invested in each asset category for all LPFs, from which actual asset allocation was available in the periods 2014-2017, independently of their size in terms of assets. A total of 35 LPFs submitted asset allocations over the four-year period ending in 2017, a subset of the total survey population. Asset allocation totals may not add to 100% due to rounding.
Source: OECD calculations based on responses to the OECD Survey of LPFs and PPRFs.

Source: OECD (2019).
Note: LPF= Large Pension Fund; PPRF= Public Pension Reserve Funds.

18. The Canadian funds have set a strong example for global funds around the world to follow, including the sequencing of reforms needed to make such diversified investment strategies a success, and measuring the success of such reforms. The most important lesson imparted by the Canadian funds is the focus on strong, independent governance, as well as the other critical preconditions that they worked through before they moved to the successful, yet complex investment approaches they employ today. Measuring the governance progress of schemes at an earlier stage of development will be important; the World Bank has developed the Social Insurance Administrative Diagnostic (SIAD) that could be used to measure such progress for

Social Security funds; other types of funds could use parallel processes relevant to their type of scheme.

Market Development and the EPF Malaysia

19. A good example of a pension fund that has been able to drive both sustainable development and beneficial pension member outcomes is the Employees Provident Fund (EPF) of Malaysia.[4] The EPF is a globally significant institution, ranking 12th on the list of the world's largest pension and sovereign wealth funds (Thinking Ahead Institute 2021). Indeed, it is larger than the ATP fund in Denmark, the Ontario and Texas Teachers in North America, and the Australia's Future Fund. Its assets are reported at the end of 2022 at Malaysian Ringgit (MYR) 1,009 billion (approximately US$ 210.8 billion) (EPF 2022), and representing nearly 62 percent of nation's annual GDP. (World Bank 2022) At that time, the fund recorded more than 15.7 million members, of whom 8.4 million, working for more than 588 000 employers, were active contributors.[5] The EPF is an interesting case study, given its lengthy history and significant domestic impact. Like many funds, the EPF has traditionally focused on objectives involving optimal return, risk, and capital protection. However, it is considering adding additional objectives that pertain more to sustainable development concerns. Additionally, it has signed on to one of the key global Environmental, Social, and Governance (ESG) Conventions.

20. In the extensive debate about whether pension funds stimulate the development of capital markets or capital markets provide the foundation for retirement funding,[6] the EPF may be a prime example of both dynamics being true. As with the Canadian funds, the assets of the EPF were heavily concentrated in government bonds in its early years. In 1960, some 97 percent of EPF assets were allocated to debt securities issued by the government, and in 1987, the percentage was still high, at 89 percent (Asher 1999). In fact, the EPF's demand for sound, reliable securities stimulated the issuance of government debt in the 1980s (World Bank 2020a). However, the concentrated EPF investment policy was strongly criticized (Narayanan 2002; Thillainathan 2002).

Generally, commentators support the view that the EPF played a significant role in the development of the capital markets:

> *"[The] EPF played an important role as an early investor to help take advantage of new opportunities for its members, which also helped to create the market. The development of the Malaysian capital market over the past 15 years has hence helped support the EPF's developing investment strategy." (World Bank, 2018a, p. 33).*

21. Significant diversification has since occurred into the debt securities of other lenders, as well as other asset classes (see table 1). Over 40 percent of the EPF's assets in 2018 were allocated to equities, real estate, infrastructure and other assets. Changes in the asset allocation from 2010 to 2018 show a consistent shift away from debt instruments and into equity, real estate and infrastructure, along with a rapid increase in the proportion of assets invested offshore, mainly in listed equity (World Bank 2018a). Jackson and Inglis (2021) suggest that the diversification of EPF assets across investment classes, in comparison with its counterparts in other countries (see table 1), reflects the respective countries' stages of economic development. This may be true, but the sheer size of the fund probably also contributes to its need for an appropriate range of investments, thus naturally stimulating the development of a wider set of asset classes (World Bank 2020a). This symbiotic process has occurred steadily over many years, with consistent yet gradual improvement in EPF asset diversification throughout that process. This has been supported by the EPF's commitment to strong, independent governance and operational excellence (World Bank 2018a), the critical precondition, as previously noted. The returns delivered by the EPF have been solid (Jackson and Inglis 2021; World Bank 2018a), at 3.7 percent annually in real terms from 2009 to 2018, that is, 2.3 percentage points above the average yield of ten-year government bonds (Jackson and Inglis 2021).

[4] Government provident funds are mandatory, fully funded, government-managed, defined contribution systems. In general, they function often as all-purpose savings programs, often serving other purposes beyond just retirement savings (Jackson and Inglis 2021).

[5] The Malaysian EPF is one of several national-level provident fund arrangements in Asia (Holzmann and others, 2000; Jackson and Inglis 2021). These schemes typically do not pay out a fixed pension. Rather, they permit withdrawals at or, in many cases, before retirement age for specific purposes. This somewhat curtails the duration of the investment pool. The EPF does not allocate to member accounts the full returns generated by assets each year, but instead declares dividends representing a proportion of the asset returns of the fund (EPF 2020). In return, the fund guarantees a minimum declaration of 2.5 percent (EPF 2020; Jidwin and others 2011), targeting a real return over a rolling three-year period of 2.0 percent (EPF 2020). Mandatory contributions of up to 24 percent of income, of which 13 percent is payable by employers, are relatively high by the standards of developing countries (EPF 2020; OECD 2021). These high rates of contribution, together with a policy of fully funding the arrangements, go some way to explaining the large accumulation of assets.

[6] Refer, for example, to Barr and Diamond (2006); Bonizzi and Guevara (2019); Carvajal and Bebczuk (2019); Catalan and others (2000); Meng and Pfau (2010); Queisser and others (1997); Thomas and Spataro (2016); Vittas (2000); Walker and Lefort (2002); and World Bank (1994). and For research with a special focus on infrastructure investing, consider Inderst and Stewart (2014); Stewart and Yermo (2012); and Sy (2017). Regarding the risks of financial repression of pension funds by government, see Davis and others (2021).

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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.

22. The EPF has been steadily increasing its commitment to becoming a more sustainable large investor and a key enabler of local development. The stated objectives of the EPF include the preservation of capital and delivery of stable and consistent long-term returns at acceptable risk (EPF 2020). Beyond this critical foundation, the EPF has been expanding its additional aspirations. In 2019, the EPF became a signatory of the United Nations Principles for Responsible Investment (PRI.) More recently, in March of 2022, the EPF took a further step with the launch of its Sustainable Investment Policy, Priority Issue Policies and Priority sector Policies. These policies will help the EPF to integrate more effectively environmental, social and governance (ESG) principles into its investment management process, by specifically targeting key sectors and focusing on both ESG exposures but also opportunities for progress.[7] Beyond these specific policies, EPF has also made commitments to two overarching sustainable investment targets, namely, to achieve a fully ESG compliant portfolio by 2030, and to have a portfolio that is fully climate neutral by 2050.[8]

South Africa's GEPF

23. The Government Employees Pension Fund of South Africa (GEPF) provides an example of a fund that has already stated a specific sustainable development objective. The GEPF is the retirement fund for South Africa's public servants. It is a fully funded, defined benefit arrangement. With assets under management of South African Rand (ZAR) 2.104 billion (US$ 131 billion), it represents over one-third of annual GDP. As such, the GEPF is one the largest 40 global entities by assets. Furthermore, it is the largest retirement fund on the African continent by a significant amount, as well as among a handful of leading funds across all developing countries (Thinking Ahead Institute 2021).[9]

24. The GEPF has specifically earmarked a portion of its investment portfolio targeted to sustainable development. In addition to compliance with the Principles of Responsible Investment of the United Nations,[10] the fund has announced its intention to allocate up to 5 percent of its asset pool to investing in development, to include transparent

[7] Recent EPF reports emphasise the broadening of its portfolio into global assets, listed and private equities, and real estate and infrastructure (EPF 2019; 2020). The EPF has committed itself to the Principle of Responsible Investment of the United Nations (UN PRI). Evidence is emerging that companies that score well in their ESG practices, such as those committed to the UN PRI requirements, have been more resilient to the recent uncertainty associated with the COVID-19 pandemic (EPF 2020).
[8] https://www.kwsp.gov.my/documents/d/guest/-download-all-epf-integrated-annual-report-2022-pdf?preview
[9] As of September 2021, GDP at market prices is quoted by the South African Reserve Bank at ZAR 6.211 billion.
[10] The fund reports two broad approaches to sustainable development investing (GEPF 2021). The general approach is consistent with the ESG foundation underpinning the Principles of Responsible Investment of the United Nations, to which it is one of the founding signatories. The PRI has a South African equivalent, namely, the Code for Responsible Investing in South Africa, typically referred to by its acronym, CRISA. However, to the ESG factors that it applies, it adds the intention to find investment opportunities that contribute to social and environmental objectives, such as job creation, improved energy security, and improved access to sound education and quality healthcare.

reporting of its progress.[11] The GEPF intends to do this without compromising its existing objective of obtaining competitive investment returns. The GEPF statement of intent (GEPF 2020b) regarding the deployment of its assets includes the objectives of: (i) providing to members the benefits promised in the fund rules; (ii) delivering investment performance that exceeds the returns of the benchmark; and (iii) applying ESG screening and selection factors to the deployment of assets to ensure a responsible approach to the selection of assets. However, the statement goes further than this by committing itself to investment for sustainable development: "*To contribute to the development of the South African and other African economies allocating in an appropriate risk-controlled way to developmental investments in these regions*." (GEPF (2020b, page 11).The investment categories identified as supporting these objectives are economic, social and environmental infrastructure, as well as a fourth category that encompasses job creation, the development of appropriate new businesses, and Broad-based Black Economic Empowerment (B-BBEE).[12] Importantly, it is important to note that the first objective in this list is to earn returns above the benchmark, even while delivering on the other objectives.[13]

25. The GEPF's recent experience has shown that unless strong governance is in place, the worthy goals of supporting local economic growth and development cannot be achieved, and the primary goal of paying pensions may be put at risk. The fund itself has a multilayered governance structure, overseen by a Board of Trustees that is supported by several specialized committees (GEPF 2021). It delegates the administration of benefits to the Government Pensions Administration Agency. The Public Investment Corporation (PIC) is mandated to manage a significant part of the investment portfolio of the fund.[14] However, recent governance failures attributable to overly centralized PIC investment decision-making have posed a significant challenge for the GEPF. A judicial inquiry in March of 2020 concluded that there had been 'substantial impropriety' at the PIC, which it connected to the fact that key internal procedures had been disregarded. Given this situation, the GEPF toughened its contractual arrangements with the PIC to embed stronger governance requirements into the relationship on a going forward basis.

26. In summary, the GEPF's multilayered objectives are a work in progress. The fund has started small and will likely adapt changes to its objectives carefully over time. As evidenced by the threefold objectives of the GEPF, strong returns continue to remain paramount. However, the efforts of the GEPF to establish clear objectives to contribute more specifically to sustainable development in South Africa over time are an interesting approach to leveraging local assets. As such, they will provide lessons (positive and negative) for others to learn from in the future.

[11] The fund aims to measure the socioeconomic impact of its investments, including the following:
- small- and medium enterprises funded,
- community trust or employee share schemes established and supported,
- jobs created,
- student loans disbursed,
- hospital beds established and supported,
- environmental projects funded,
- units built in housing projects for low-income beneficiaries,
- indirect jobs reported through its property portfolios,
- farms for emerging owners supported, and
- farm workers and their children with newly provided access to health care and education. (GEPF 2020a; 2021).

[12] Black economic empowerment refers to the legislated and well-established policy of providing appropriate opportunities for skills development and ownership to people in those sectors of society who have been systematically denied these opportunities during the Apartheid era that ended in 1994. In the language commonly used in the country, to contribute towards the transformation of South Africa typically means taking explicit steps to redress past wrongs built on the foundation of racial injustice, inequity and the systematic denial of opportunity.

[13] Consistent with its commitment to transparency, the GEPF discloses the private equity firms to which it has allocated assets and, as part of its publicly available financial statements, a full list of debt instruments, properties and listed equity holdings (GEPF 2021).

[14] The PIC, which dates to 1911 (GEPF 2021; Hendricks 2014) manages the assets of entities owned by or associated with the State, among them the Unemployment Insurance Fund. This is done though the GEPF and provides the largest proportion of its assets under management.

Unlisted Asset Investing in Namibia

27. Namibia provides another example of the importance of the strong governance needed to successfully diversify investments and support sustainable development. This example portrays both a cautionary story from the past, as well as an innovative approach currently being implemented. The inclusion of a statutory minimum investment requirement is one that is not normally recommended as good practice by international standards. As such, it highlights even more the need for strong governance and oversight of funds.

28. Namibian policymakers and commentators have long sought to take advantage of the potential to match the considerable assets of the country's institutional investors with the financing needs of small businesses. A significant body of literature recognizes the importance of small businesses to the success of economies of developing countries. This literature explores mechanisms to facilitate access to finance for these businesses.[15] As a small, middle-income developing country, helping small business to grow is a focus for the country.[16]

29. Like South Africa, Namibia has a large pension industry with a dominant public pension fund. The Government Institutions Pension Fund (GIPF), which covers the country's civil servants, alone holds assets worth 60 percent of GDP. The remainder of the pension fund industry is fragmented across 250 occupational and personal funds covering around 30 percent of the workforce (Namfisa 2021). These funds have total pension assets amounting to over 90 percent of GDP (OECD 2021). Assets reported for other institutional investors are also quite significant. Long-term insurers, collective investment schemes and investment managers reported assets in 2020 of Namibian Dollar (NAD) 147 billion (US$ 9.8 billion), a total equivalent to more than 80 percent of the assets held by pension funds.[17]

30. The size of the local institutional investors' assets dwarfs the potential investment opportunities in the small and illiquid domestic market for listed assets (World Bank 2020b).[18] Consequently, whereas 45 percent of pension fund assets are invested in Namibia (by regulation), 21 percent are invested in the Common Monetary Area (South Africa, Namibia, Eswatini and Lesotho), with the remaining third of assets invested outside the country. By investment class, approximately 52 percent of assets are in listed equities, and nearly 30 percent are in fixed-interest securities. The financial sector regulator, Namfisa (Namibia Financial Institutions Supervisory Authority), which oversees pension funds, reports a 1 percent allocation to unlisted investments, amounting to approximately NAD 1.8 billion (US$ 120 million). An additional 3.9 percent (NAD 7 billion, US$ 470 million) are in 'other' asset classes, the details of which are not disclosed (Namfisa 2021). Even when considering the assets that are listed in the country, many do not, in fact, represent Namibian interests as they are dual listed with another exchange, in many cases, with the Johannesburg Stock Exchange in South Africa (World Bank 2020b).

31. Previous, unsuccessful attempts were made to use the capital held by pension funds to support domestic investment opportunities. The GIPF established its Development Capital Portfolio (DCP) in 1996. This aimed to promote socioeconomic development and give entrepreneurs entree into mainstream economic activity. The initiative failed, primarily because of poor skills, a lack of capacity and, notably, inadequate governance on the part of the GIPF overseeing the investments (World Bank 2020b). Specifically, the DCP investments were made without a regulatory framework and without any supervision. Due diligence was lacking, and investment decisions were made in a suboptimal manner. The portfolio was closed in 2010, with 84 percent of the investments written off as of 2010 (IMF 2008; World Bank 2020b). The DCP provides a cautionary tale of what can go wrong when governance is insufficient.

[15] For examples, refer to Bárcena and others (2011); Dalberg (2011); Herrera (2020); IDB (2014); IFC (2010); OECD (2015); and Powers and Magnoni (2010).

[16] Namibia's GDP stands at NAD 180 billion (US$ 12.2 billion), with a per capita GDP of approximately NAD 70,000 (US$ 4,700). It has a population of approximately 2.6 million (IMF 2021b). Unemployment is cited by the national statistics authority at 33.4 percent for 2018, slightly down as compared to 2016, but sharply up from 2014 (NSA 2019). Inequality is high, with a Gini coefficient for 2015 estimated at 59.1, which is the second worst only to South Africa on the World Bank database. However, it is on a downward trend (World Bank 2021). The Namibian dollar trades to the US dollar at a rate of NAD14.89 to US$ 1.00 at the time of this writing. This rate is used for all currency conversions in this section.

[17] These figures are lower than the sum of the corresponding assets reported by each of the entities because Namfisa (2012) reports remove pension fund assets from these amounts to avoid double-counting. These entities typically have less freedom than pension funds to allocate assets to development initiatives. They are generally subject to tighter commitments to their customers, and the outlook for their assets is frequently somewhat shorter than for pension funds.

[18] In fact, given the consistent relative large size of the pension market in Namibia, the country is consistently rated first in the annual 'Absa Financial Market Index' in terms of local investor capacity (Absa Africa 2023)

32. Despite the lack of success with the DCP, regulations were eventually passed requiring all pension funds to invest a small percentage of their assets in unlisted assets in the country. Commentators continued to note the disconnect between the available assets in the country and the inadequately developed market for financing small businesses.[19] By 2008, serious consideration was being given to the possibility of a minimum allocation to unlisted local investments, that is, 5 percent of the assets of pension funds — despite comments/concerns raised by the International Monetary Fund (IMF), amongst others (IMF 2008).[20] A stipulation to invest a minimum proportion of fund assets in unlisted equities was eventually passed in 2014. This was set at a level of 1.75 percent of assets, rather than 5 percent, with a stated maximum of 3.5 percent. Although this approach of mandating a minimum level of allocation is not generally in line with international best practice,[21] the fact that the minimum level of allocation was quite small meant that their projected investment returns would not be materially impacted, thus ensuring they could essentially continue to meet their fiduciary obligations to members to seek the best possible returns (World Bank 2020b).

33. Learning from the earlier experience of the GIPF with the DCP, Namfisa has insisted on minimum standards of governance and licensing for these unlisted local investments. Investments can only be made with registered, unlisted investment managers, and only through the channel of a special purpose vehicle. This vehicle also had to be registered with Namfisa, meeting stipulated minimum regulatory requirements. In addition, the unlisted investment manager is required to take a stake in the special purpose vehicle (World Bank 2020b). The new model has contributed meaningfully to improving the governance of and within pension funds. In the view of the regulator, Namfisa, the new environment and structure has improved due diligence of unlisted investments and the investment process. It has also reduced the public perception of corruption (World Bank 2020b).

34. Market development has been broadly satisfactory since the implementation of the regulatory requirements (Johns and others 2018; Sherbourne 2018; and World Bank 2020b). The capital committed to these vehicles was reported at NAD 3.3 billion (US$ 220 million) at the end of 2018. This amounted to approximately 2.1 percent of pension fund assets at the time, spread over a broad range of industry sectors (World Bank 2020b). Johns and others (2018) express optimism that progress made in this regard contributes to the potential for skills development, employment, public-private partnerships, as well as co-investment with foreign institutions with an appetite to invest in Namibia. Focused attention on small businesses in Namibia has also stimulated research into their financial and operational needs (Amadhila and Ikhide 2016; Kangombe 2016; and Mukata and Swanepoel 2017).

35. In the wake of the regulatory requirements, the GIPF, in particular, has continued to play an active part in investing for development. With assets of NAD 108 billion (US$ 7.25 billion), representing over 60 percent of GDP (GIPF 2020), the GIPF is an enormously influential player in the market. It expresses its responsibility through its vision "to be a leading and model pension fund globally" (GIPF 2020,p. 18). The Development Investment Policy of the GIPF describes the aim of the fund as follows: to contribute to development in six key economic areas and in terms of a broad list of objectives (GIPF 2020, pp.29 and 96). The fund reports a total commitment of NAD 7.4 billion (US$ 500 million) to the domestic unlisted sector, including investment in renewable energy, affordable housing, health, land-servicing, job-creation and important substitution projects in manufacturing and agriculture.[22] In the interests of transparency, the fund lists the value of its investments with each of its appointed asset managers (GIPF 2020) and each private equity holding (GIPF 2021). It also provides substantial supporting information regarding the social benefits of its investments, along with several case studies.

[19] Tonin and others (1998), writing for an economic policy unit, put forward several ideas for developing the provision of credit to small businesses, among them the establishment of specialized micro-finance institutions and strengthened research capacity. Uanguta and others (2004), writing for the Research Department of the Central bank, that is, the Bank of Namibia, described the inconsistency between the significant savings and poor local development. They suggested that long-term insurers and pension funds, with their long-term liabilities, might be in the best position to stimulate investment in the Namibian market. Zaaruka and others (2005), also at the Bank of Namibia, built on this and the policy statements of government in the second national development plan. They proposed a concerted effort to develop the private equity industry. They suggested that this should be underpinned by institutional investors. They also noted the resolution of the Cabinet forcing an allocation by these entities into unlisted entities as a catalyst for the development of private equity. Broader interest in the subject was high, as evidenced by several academic theses exploring different aspects of the matter.

[20] Further support for strategies to invest in the development of small and medium enterprises was provided by the Government's Vision 2030 Strategy Paper (Namibian Presidency 2004), the Fourth National Development Plan (NNPC 2012), and the Financial Sector Strategy for 2011-2021 (NMF 2011).

[21] OECD Core Principles for Private Pension Regulation (2016), Core Principle 4.

[22] This represents a considerable increase in the total allocation across the industry reported for 2018 (World Bank 2020b).

36. The initiative to stimulate the development of small business in Namibia by mandating the allocation of assets to private equity[23] arrangements has not been without challenges (World Bank 2020b). Specifically, the commitment period required under the capital drawdown regulation by the special purpose vehicle is two years, which is short by global standards.[24] Additionally, as noted, the model diverges from known global best practices. Nevertheless, given the history of the poorly governed approach to the DCP and the initial market growth under the new approach, it seems reasonable to conclude that a more strongly governed process has provided the needed impetus for a more meaningful set of contributions.

37. A viable, sustainable investment class appears to have been established, with considerable benefit for socioeconomic development, as well as the potential to stimulate a virtuous cycle of further investment. The keys to this success appear to lie in the commitment of all parties to the policy objective. Leadership from the highest office, the National Planning Commission and the Ministry of Finance, was supported by a commitment to research, to sound regulation, and to careful implementation by the dominant investor. Lessons appear to have been learned along the way, and the evidence is clear that the impact of better governance can be significant.

38. The preceding country examples portray good examples of how pension funds, as key local investors, can play an important role in contributing to sustainable development. The example from Canada showed the power of improving governance, while the example from Malaysia provided an interesting case of parallel growth in the fund and the local market. The cases from both South Africa and Namibia provided concrete examples of how to approach this work.

BOX 1. PENSION FUNDS AS INVESTORS IN SMALL AND MEDIUM ENTERPRISES

As already noted above, pension funds have a first responsibility of delivering sufficient returns to be able to pay beneficiaries, to whom they have their primary duty. As they fulfill this primary responsibility, they should be looking for opportunities to diversify their investments and match their investments against their long-term liabilities to beneficiaries. Among the types of assets that can sometimes be considered in this important work are investments that contribute toward the development of local small enterprises.

The unlisted asset example in Namibia is one approach that was used to encourage more pension fund investment in small and medium enterprises (SME). SMEs are often critical to growth in emerging markets because they constitute 45 percent of employment and 33 percent of GDP in those economies (World Bank 2020d). They are important contributors to job creation and global economic development worldwide, but especially in these economies. Further, bank financing, traditionally the key source of financing for SMEs, has not been sufficient. As such, when the economic case for investment is strong, institutional investors can sometimes help bridge a significant financing gap.

In general, the nature of SME investment can often fit well with the needs of pension funds. Pension funds have the capability to be patient, long-term investors. SME investments may provide interesting local diversification opportunities in those cases where appropriate local assets are relatively scarce. More compelling, however, may be the reality that many countries have now implemented non-contributory social pensions. Thus, in a context in which such programs will provide a backstop protection for those with insufficient individual retirement savings, it may be appropriate to allow pension funds to play a role in funding greater current employment (leading to greater individual retirement savings) so that future contingent liabilities are reduced. This type of encouragement requires careful calibration to ensure pension funds are not unduly burdened by such an approach. (Rudolph and Zviniene, forthcoming)

[23] Of note, the Namibia approach was described as private equity investing locally but is globally more similar to angel or early-stage seed investing. Therefore we have described this section as 'unlisted asset investing.'

[24] The commitment period was specified in this way because the regulator, Namfisa, was concerned about incentivizing momentum from the outset.

An example in Africa serves to illustrate the possibilities. The Uganda National Social Security Fund (NSSF), working in partnership with the Mastercard Foundation (2021), has recently launched an entrepreneur support program. It is known as the Hi-Innovator Program. Under this program, the NSSF will invest in a number of candidate firms, while also providing them with support to assist in their success. The program is intended to create 132,000 new work opportunities in the next five years.

Recently 28 of the businesses selected through an initial phase were approved to proceed to a second portion of the program. One of the eligibility requirements for the program includes the participation of the candidate company's employees in the NSSF retirement scheme. In this manner, if the goals for increased employment take root, the NSSF will also achieve coverage increases, as well as aid in the achievement of national employment goals. Pension funds can become a more significant force in supporting the growth of SMEs and the larger economy in many ways, albeit indirectly. Depending on how these opportunities are structured and governed, they can fit into a diversified portfolio. Ideally, they can contribute to the growth of investable local instruments in a meaningful way, if structured correctly.

Improving Governance and Diversification via Investment Pooling

39. An interesting and innovative approach that has unlocked the potential of local investors in certain countries globally is the concept of pooling – for expertise, for capital, and for diversification. In addition to strengthening their own governance and expertise, pension funds are increasingly working together to pool investments, and sharing resources to achieve their goals of diversifying investments and contributing to economic development and growth. Pooling investment expertise and capital together has recently emerged as a key strategy for pension funds to achieve diversification. As such, they are able to consider investments in a broader range of markets and asset classes. In addition to the diversification benefits, this approach has the potential to aid sustainable development goals. Such collaboration started with pension funds in developed markets, but it has also been spreading to local pension funds in developing economies.[25] Importantly, just as it is critical to ensure strong governance for standalone pension funds, it is equally important to preserve good governance arrangements as a part of the various approaches to pooling as well.

40. South Africa's pension funds have announced the establishment of the Asset Owners Forum South Africa to invest in infrastructure and other development assets. The initiative was established by the funds themselves, who cumulatively manage an estimated ZAR 3 trillion (US$ 158 billion) in assets. This was done through the Batseta Council of Retirement Funds for South Africa, together with the United States Agency for International Development (USAID) and the World Bank. The investment opportunities identified are not expected to be limited to the founding members, as it is hoped that small and medium funds will also contribute to the intended pool of available assets (Citywire 2021).

[25] Caisse de dépôt et placement du Québec (CDPQ) in Canada is one such example. It pools the assets of several asset institutional owners to take advantage of the available scale, deliver more sustainable returns, and help develop the Province of Quebec (CDPQ 2020a and 2020b). A case which demonstrates an alternative evolution for domestic pension funds is Industry Funds Management (IFM) Australia. It began as a grouping of pension funds seeking long term infrastructure investments. However, it initially lacked internal skills. Members agreed on its investment strategy, but they relied on external advisors and investment managers for execution. After 15 years, it established a holding company owned by various industry funds, brought investment functions in house, and established a regulated pooled trust, which was used to make investments. It was able to establish the scale and skills to provide a low-cost model, segmenting its funds across infrastructure, debt, and listed and unlisted equities with US$ 129 billion in assets under management (AuM) (IFC 2021).

41. Elsewhere in Africa, the Kenya Pension Funds Investment Consortium (KEPFIC) is a grouping of Kenyan retirement funds working collectively to make long-term investments in infrastructure and other alternative assets in the region. With recent changes to the pension investment guidelines in Kenya, funds can invest up to 10 percent of their assets into infrastructure, potentially unlocking over US$ 1 billion of possible investments into these asset classes. The World Bank has been an active supporter of this effort. In this regard, it has also helped to enable linkages with overseas pension funds alongside the local pension fund group. The consortium in Kenya has been particularly promising, given vast infrastructure needs, a solid commitment from the Kenyan government, and a strong public-private partnership (PPP) program pipeline based upon work started originally in 2012 (KEPFIC 2022).

42. In the Pacific region, the Pacific Islands Investment Forum has also begun work to collaborate on key regional infrastructure projects (IFC 2021). This network of 18 funds from 12 countries has approximately US$ 8 billion under management. As such, it has the potential to help meet a substantial set of infrastructure needs for the widely scattered small independent states represented by its member funds. It is estimated that from 2016 to 2030, these nations will need US$ 46 billion in investments to overcome their infrastructure deficit. However, given the small size of the funds and the difficulty of obtaining the skills needed to effectively oversee complex investments in infrastructure, this need has not yet been well addressed by these funds. For this reason, the funds began a collaboration effort, supported by the International Finance Corporation (IFC). As part of this effort, they are studying six possible approaches to co-investment. These

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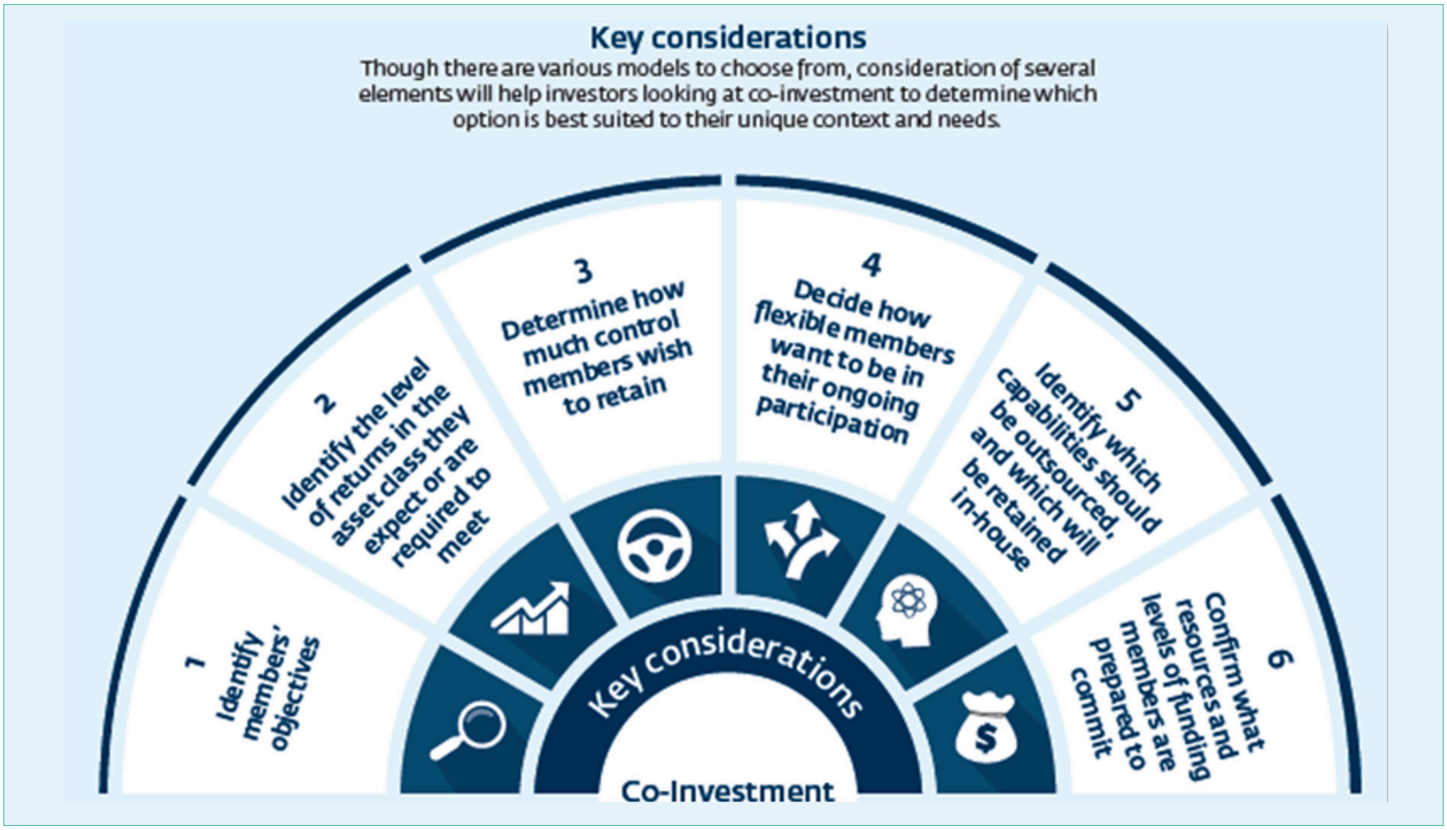
Figure 7: Factors to Consider with Co-investment Models


Key considerations
Though there are various models to choose from, consideration of several elements will help investors looking at co-investment to determine which option is best suited to their unique context and needs.
1 Identify members' objectives
2 Identify the level of returns in the asset class they expect or are required to meet
3 Determine how much control members wish to retain
4 Decide how flexible members want to be in their ongoing participation
5 Identify which capabilities should be outsourced, and which will be retained in-house
6 Confirm what resources and levels of funding members are prepared to commit
Key considerations
Co-Investment

Source: IFC (2021).

approaches range from simple information and collaboration platforms to co-owning a listed company that undertakes a full range of investment activities to meet the needs of various stakeholders. Following a rigorous assessment of the factors outlined in figure 7 above, the funds agreed to take a collaborative platform approach, whereby funds pre-agree on investment criteria and governance arrangements. They also agree to share early co-investment opportunities. However, they then co-invest on a case-by-case basis.

43. The pooling of funds with international financial institutions (IFIs) and foreign institutional investors can also assist in achieving the various goals related to investment returns, development impact, strong governance, and risk mitigation. Local investors can provide expertise concerning the domestic political economy and institutional environment, as well as local currency, patient domestic capital, and potentially earlier access to new investment opportunities. Partnering with IFIs, in turn, provides: (i) access to foreign currency; (ii) project structuring expertise; (iii) long-term international capital; (iv) adherence to globally recognized standards; (v) beneficial financing terms; and (vi) a range of risk mitigation tools, including through blended finance. A particular tool which has been rarely used, but could be leveraged further in emerging economies, is the guarantee. It can serve to improve credit ratings of specific projects, as well as at a fund level (G7 Impact Taskforce 2021). With an IFI entrenched in a project or fund structure, as well as more favorable financing terms and risk mitigation, this can provide the confidence to attract other international institutional investors.

44. An example of this is the Ninety-One Africa Credit Opportunities Fund 2, which is a senior private credit fund focused on African corporate debt capital markets. It was seeded initially by IFIs to address the demand for credit in Africa, which exceeds supply. Thus, the aim was to build up private credit as an asset class in Africa. It focuses on investing in leading companies in the financial inclusion, infrastructure, and telecommunications sectors. Once it had built a track record through its publicly listed fund manager, it crowded in local pension funds and international institutional investors, including Allianz, the global insurer. It follows IFC's performance standards for ESG reporting. By partnering with IFIs, the Fund was able to undertake innovative investments.

45. Another fund, the US$ 200 million International Housing Solutions (IHS) Fund II in South Africa, targets affordable housing opportunities and applies the IFC's green building standards, Excellence in Design for Greater Efficiencies (EDGE), to all housing projects. The fund invests in acquiring and developing affordable and green residential housing in South Africa. The fund, denominated in local currency, includes equity from multiple development finance institutions (including Germany's KfW and IFC), grant capital (effectively blended finance) from the Global Environment Facility, as well as a loan guarantee from the Development Finance Corporation (G7 Impact Taskforce 2021).

46. Pooling offers an additional tool to local pension funds that may aid in diversification ambitions and return enhancement, as well as the accomplishment of sustainable development goals. Pooling offers the advantages of increased scale and expertise so often vital to the success of an investment. Additionally, the involvement of international partners (especially IFIs) can provide some key advantages.

IV.

Revealing Hidden Areas of Opportunity in Pension Savings

47. In addition to known local investors, sources of potential investment may also exist in emerging markets. These sources could be better leveraged, both to the advantage of beneficiaries, as well as for their possible contribution toward sustainable development. Multiple examples are presented here, beginning with instances of underregulated and conservatively invested funds from South Asia, and then moving to cases where further growth in long-term savings has been desired by those in the informal sector. Thus, new schemes have been developed to accommodate those ambitions.

Unregulated Provident Funds in South Asia

48. One example of the untapped potential of local investors is the unregulated provident funds which exist in some South Asian markets, such as in Bangladesh and India. The government in India, in partnership with the Pension Fund Regulatory and Development Authority (PFRDA), has held discussions over time on amendments to the law that would increase the regulatory oversight of funds that in some cases are not subject to adequate supervision. Past estimates indicate that there could be a significant number of these funds. (Times of India 2021) Increasing the oversight level of these funds would lead to improved and more diversified investment within their portfolios.

49. Likewise, Bangladesh's largely unregulated provident funds represent a key opportunity in terms of the prospect for improved investment practices and their potential contribution to sustainable development, as well as improved outcomes for members.[26] These funds are estimated to total at least US$ 6 billion (World Bank and IMF 2020). However, currently, they are largely invested only in bank deposits and retail savings certificates (known as National Savings Certificates - figure 8 portrays a stylized representation of a typical provident

[26] Although provident funds do need to register with the Revenue Authority to attain tax exemption, this is a one-time exercise. It does not result in ongoing oversight, which means that regulatory supervision is not present on an ongoing basis. Additionally, some of the provident funds are required to report to the Labor Ministry on an annual basis, but without adequate follow-up or effective oversight.

fund).[27] The limited amount of investment into capital market instruments is an outgrowth of both low demand but also limited supply of appropriate investment instruments. But if even just a small portion of these pension savings were diverted to more productive investment in Bangladesh it would make a significant difference in the prospects for growth in that country, as well as in the potential for improved returns to participants. Yet, before dramatic changes to the investment approach of the Bangladesh provident funds are implemented, the quality of governance of these arrangements must be raised. Indeed, this is a critical precondition.[28, 29]

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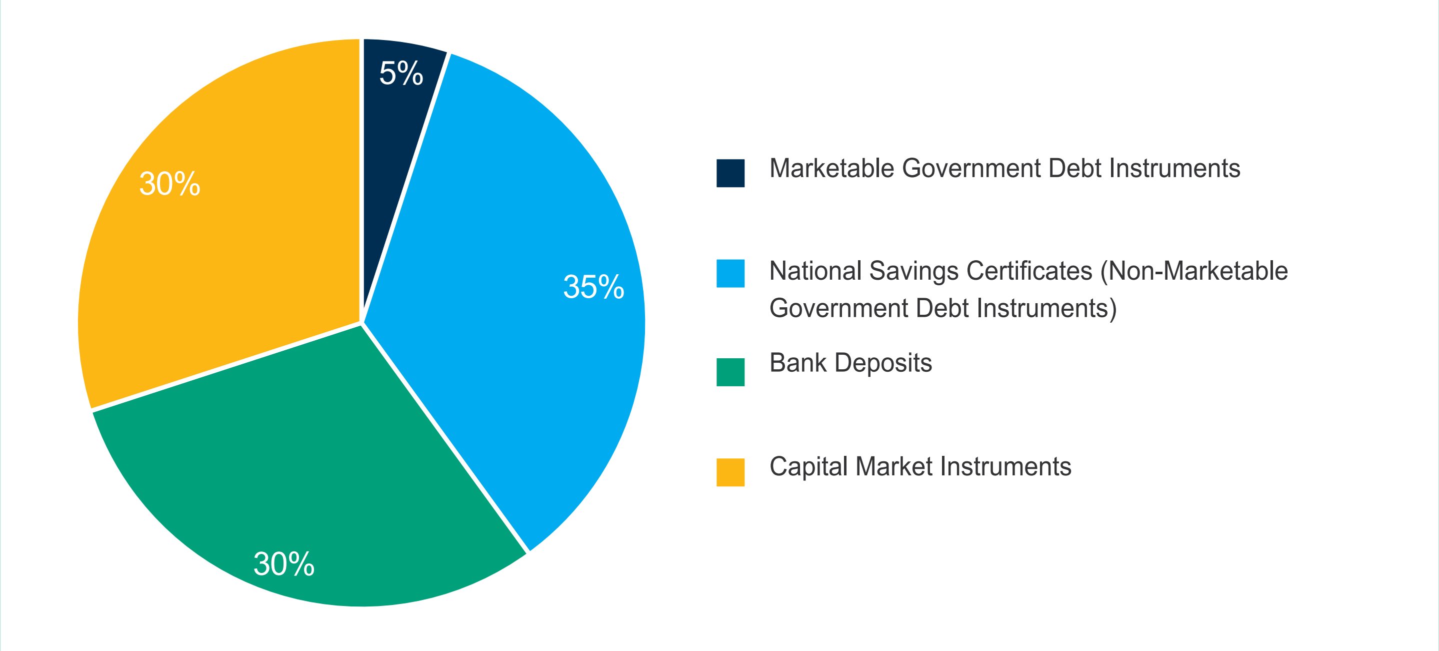
Figure 8: Stylized Provident Fund Portfolio: Bangladesh



Source: Authors' calculations based on data from unpublished working paper

Long-term Savings Arrangements for Informal-sector Workers

50. A large proportion of the world's workers survive under very difficult circumstances, especially when their prospects for retirement income are considered. Many of them are employed by unregistered entities that do not pay for their social security, or meet the minimum standards required of employers in most countries, such as paid annual leave or sick leave. Despite some signs of improvement (Maurizio and Vásquez 2019), the levels of informal employment in developing countries remain high, particularly in Africa (OECD and ILO 2019, see figure 9). In this context, it should be noted that these informal entities contribute to large proportions of economic activity, up to half in many countries (La Porta and Scleifer 2014).

51. The economic activity of these informal firms — including the numbers of workers that they employ and the financial lives of these employees — are, almost by definition, difficult to measure (IMF 2021a). Thus, the policy debate regarding these companies and their workers

[27] The government has recently limited investment by Provident Funds into National Savings Certificates to no more than 50% of a portfolio. The impact of this new limit is as yet unknown.

[28] Ideally, the coherence of the existing fragmented legislative and regulatory universe applying to these funds is improved, with a single regulator and supervisor responsible for oversight. Trustees should be better trained, and their selection processes should be strengthened to include a fit and proper requirement.

[29] Given the potential of an estimated US$ 6 billion in total assets (considering both the private and public funds), moving just an additional 10-20 percent of those assets toward more productive and long-term oriented investment would make a meaningful difference in prospects. A recent government study cited by Zaman (2022) indicated that Bangladesh would need approximately US$ 70 billion between 2021 and 2030 to accomplish its SDGs. These prospective amounts of investment would start to make an impact toward meeting this need.

continues (La Porta 2014). It is increasingly clear that, for the purposes of providing appropriate social protection to these workers, they cannot be considered in the same way as their formal-economy counterparts (Guven 2019). Specifically, they may not have regular incomes or savings of any kind. They are significantly exposed to short-term shocks of various kinds. Also, they cannot be regarded as homogeneous in their attributes or needs. In addition, they are typically difficult to reach, though they are frequently organized in some way. These workers also are not likely to retire from their jobs as their formal-sector counterparts do (Rutherford 2009).

52. Most importantly, these workers have a need for, and an interest in, building long-term savings. In many of the countries in which informal-economy employment predominates, contributory pension arrangements are only realistically accessible to formally employed individuals, covering a small proportion of the workforce. Typically, in these countries, universal old age arrangements either do not exist or are limited in the protection offered. As such, they are likely to come under financial pressure as the working population ages (Guven 2019). The discussion that follows summarizes the arrangements in several countries, touching on the framework for contributions and benefits; the extent to which members have been attracted and assets have accumulated; and the investment strategies of these plans.

53. Among the most notable efforts aimed at long-term savings arrangements for informal workers are initiatives in Africa and India (Guven 2019). Key to the implementation of these arrangements is a recognition that the solution to the problem of poor coverage cannot be formulated by expanding formal-sector arrangements, which are not well suited to the needs of these workers. These arrangements are also typically not attractive to them either. First, variable and uncertain incomes mean that they are likely to find it difficult to meet the requirements of regular contributions. Second, the financial shocks to which they are exposed call for some access to retirement savings in advance of old age.

54. Rwanda has tapped into existing capabilities as part of its strategy to provide micro-pensions to as wide a proportion of its people as possible. The Ejo Heza Long-term Savings Scheme is a flexible, defined contribution arrangement that is managed by the Rwanda Social Security Board. The Board also administers the scheme provided to public-sector workers. Ejo Heza membership is based on national identity numbers. Contributions may be made through various electronic media or through a range of physical pay points at bank branches or agencies, cooperatives, and mobile money providers, to name just a few. Members may contribute as much and as frequently as they wish. They are granted access to 40 percent of the accumulated savings for housing and education. The same amount may be used as collateral for borrowing, and 25 percent may be withdrawn for any purpose.[30] The government is also offering incentives to encourage individuals to save. These incentives are in the form of matching contributions and free insurance coverage.[31] Long-term savings are expected to grow to some RWF 200 billion (US$ 200 million) within five years (Guven 2019), amounting to some 2 percent of GDP. Assets are expected to be allocated to liquid securities, such as Treasury bills, bonds, and bank deposits, thus protecting member savings (Nsengiyumva 2021). To date, although coverage rates have been successful (with over 2 million members), savings amounts remain relatively limited (with US$ 20 million accumulated).

55. The Kenyan Retirement Benefits Authority, as part of its contribution to national strategy (KRBA 2018 and 2019), has also been supporting pension schemes targeted at informal-economy workers. The Mbao scheme was the first in the world to target informal sector workers using the digital finance and mobile money platforms. Members may contribute whenever they wish to, using mobile technology. They are subject to a minimum contribution of Kenyan shilling (KES) 20 (US$ 0.20) per working day, or the equivalent annual contribution of KES 4,800 (US$ 48) (Kabare 2018).[32] Accumulated contributions may be withdrawn in full after three years. Within approximately a year of its launch, the Mbao scheme had 38,000 members, who had saved KES 37 million (US$ 370,000), largely due to the ease offered by the technology provided by mobile telephony provider, Safaricom (Kwena and Turner 2012). After an initial period of growth in which the arrangement grew to cover just over 75,000 members and had accumulated assets of US$ 1.3 million (Kabare 2018), interest waned, and the scheme lost members. The freedom to withdraw the full amount of the

[30] Nsengiyumva (2021) notes that these allowances may be subject to the achievement of a minimum level of savings of Rwandan franc (RWF) 4 million (US$ 4,000).

[31] Government incentives over the first three years included a contribution of up to RWF 18,000 (US$ 18). These depend on the corresponding contribution of the member and free life insurance of RWF 1 million (US$ 1,000), along with a contribution to funeral costs of RWF 250,000 (US$ 250) (Guven, 2019; Nsengiyumva 2021). The exchange rate as of end-2020 was approximately RWF 1,000 to US$ 1. This rate is used throughout the description.

[32] The exchange rate of approximately KES 100 to US$ 1 at the end of 2020 is used throughout.

savings may have contributed to this decline. An alternative arrangement aimed at employees working in the formal economy was registered with the Retirement Benefits Authority in December 2021. It is called the Kenya National Entrepreneurial Savings Trust (KNEST), and it is expected to launch during 2024. The National Social Security Scheme (NSSF) has also launched a scheme known as Haba Haba. It targets workers not currently in formal employment, attracting around 500,000 members to date.

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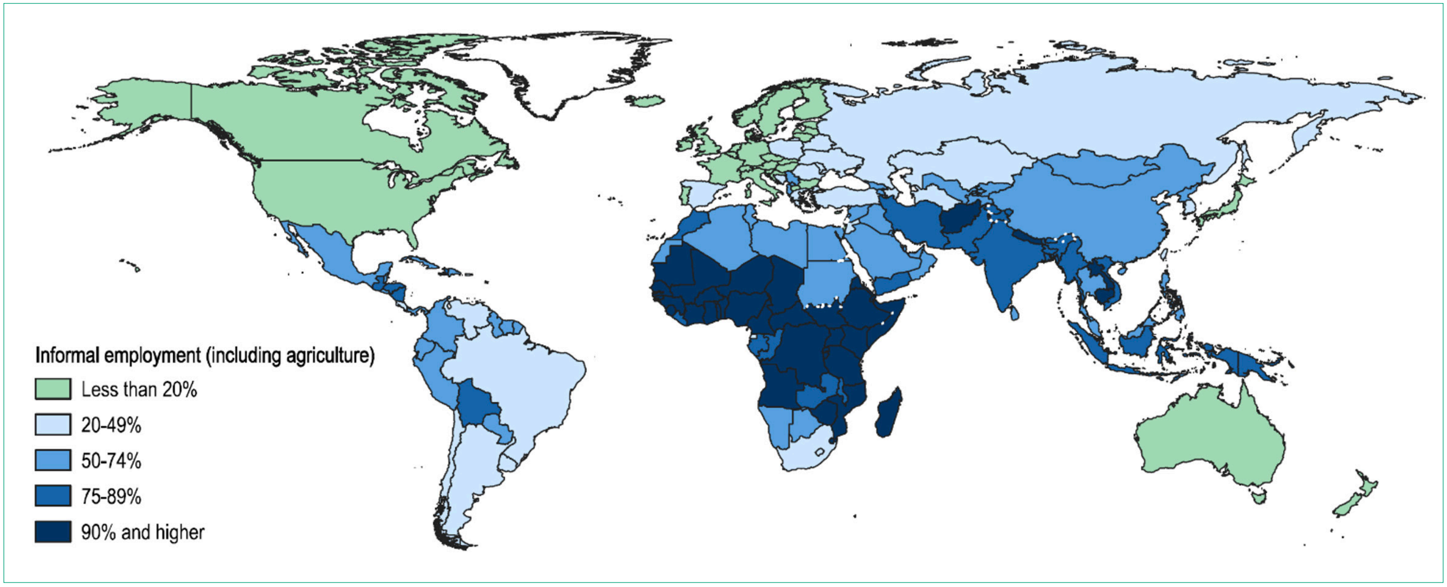
Figure 9: Share of Informal Employment as part of Total Employment



Source: OECD and ILO (2019), p. 27.
Note: The data applies to the year 2016 and includes agricultural workers. Own-account workers and employers are defined as being in informal employment if the businesses that they run are in the informal sector. Employees are regarded as being in informal employment if their employers do not contribute to social security for them, or if they do not enjoy paid annual leave or sick leave.

56. An example from India encompasses an investment approach most likely to preserve long-term, real purchasing power. India sought to tap into the economies of scale available in the NPS by incentivizing contributions to the NPS-Swavalamban. This is an arrangement established for workers in the informal economy. Participants may invest amounts from Indian rupee (INR) 100 (US$ 1.40).[33] The government offered a top-up of INR 1,000 (US$ 14) in the early years to participants who contributed a total of at least INR 1,000 (US$ 14) in a year (Mitchell and Mukherjee 2017; Sane and Thomas 2015). Withdrawals before the age of 60 are permitted, but they are limited to 20 percent of the accumulated assets. Significantly, unlike many similar arrangements elsewhere, money was not invested in capital-guaranteed assets such as cash. Rather, it was invested in equities and bonds according to a 40/60 ratio. This served as a means of retaining the real value of contributions (Mitchell and Mukherjee 2017).

57. The India schemes have seen good uptake, with not inconsiderable assets accumulated to date. Some 1 million participants signed up for the NPS-Swavalamban (Sane and Thomas 2015). The scheme was converted to the Atal Pension Yojana (APY) in 2015, which provides a guaranteed pension. Members of the NPS-Swavalamban who were under 40 years of age at the time were given the option to migrate to the APY (Department of Financial Services 2022). By March of 2023, APY had 45.9 million subscribers, with accumulated assets of INR 272 billion (US$ 3.28 billion) (NPS Trust 2023)[34]. In this context, Mitchell

[33] The end-2020 exchange rate of approximately INR 71 to US$ 1 is used in all conversions.
[34] https://npstrust.org.in/sites/default/files/annual-reports-document/V16-Annual_Report_of_NPS_2023.pdf

and Mukherjee (2017) report high levels of interest among surveyed individuals in the opportunity to save in small amounts. They indicated an appreciation for the inability to access assets until old age and appreciate the government subsidy. They, too, note the need for improvements in financial literacy alongside a program such as this one.

58. Other countries have made progress with pension arrangements offered to informal-economy workers. The National Social Security Fund (NSSF) in Uganda has had some success in retaining the membership of members who had previously joined on a mandatory basis as employees, and then shifted into self-employment. They then chose to remain on a voluntary basis. Launched in 2005, the scheme of the Social Security and National Insurance Trust (SSNIT) initiative in Ghana targeted informal workers (Guven 2019). It has since spawned others, such as My Own Pension, a private-sector initiative that aims to attract contributions from formally employed workers, as well as those in the informal economy. Nigeria's retirement regulator recently reported the registration of 72,000 members to that country's micro pension plan. (Iwayemi 2021). Interest in such arrangements continues to grow all over the world. The government of Vanuatu has also announced a feasibility study into micro-pensions for that Pacific Island country (UNDP 2018).

59. Several studies are cited in this discussion, confirming the interest among low-income households for long-term savings vehicles. It is estimated in India that some 80 million workers have the capacity to save for retirement, with a potential for additional annual contributions of some INR 110 billion (US$ 1.55 billion). Not all arrangements that seek to meet the needs of informal-economy workers have succeeded in equal measure. However, the number of such arrangements is likely to grow as governments, regulators, and private-sector players continue to apply a range of improvements to existing approaches to meet policy objectives.

60. These schemes may begin with a more conservative investment approach; however, ultimately, they should seek to invest in such a way that they can provide for the long-term real income of participants. Many of these schemes aim to provide meaningful access to a portion of the accumulated assets of participants prior to retirement. As such, they are not as clearly long-term in their investment outlook as many pension funds. Furthermore, in the early years of these schemes, when assets are not large and a reputation for sound investment is important, an emphasis on capital protection may be called for, especially given relatively lower levels of financial literacy. In the long run, however, real returns need to be achieved to preserve long-term purchasing power. Also, some allocation to asset classes that grow with wages and the economy is called for. In this regard, if they exist, they should be appropriately governed and offer suitable return prospects in accordance with their level of risk. This need may fit well with concurrent needs to invest in well-governed initiatives in those same countries that could more meaningfully contribute to sustainable development there.

61. As Guven and others (2021) highlight, the investment approach depends on the stated goals of the arrangement. Herein may lie the opportunity to communicate to all stakeholders the potential offered through an appropriate portion of investment in developmental assets, along with the corresponding risks. Furthermore, the dollar amount of the risk is low. However, in the early years of a new scheme, perhaps governments could play a part in underwriting the arrangement, thus guaranteeing that annual returns will not be negative. This support could be phased out over time. Again, the message is that a clearly stated commitment to investing a portion of assets toward sustainable development must be supported by strong governance and clear communication. It could also encourage greater participation by those who stand to benefit the most, not only from their savings, but from the investment that it generates. In this way, these 'hidden' pools of prospective savings will be best utilized.

BOX 2. HIDDEN LOCAL INVESTORS

This paper contends that local pension funds represent a potentially significant force in providing local currency sources of investment. Beyond these entities, however, there are others that should be considered as possible providers of capital in a local context. Indeed, they would fit appropriately with their stated missions.

One example would be the Hajj funds of Southeast Asia. These funds are amassed to help fund an annual pilgrimage to Mecca, Saudi Arabia. The pilgrimage is regarded by Muslims as one of the five pillars of adherence to Islamic practice (Muheramtohadi 2019; Muneeza and others 2018; Rusydiana and others 2021). The accumulated funds set aside for the pilgrimage in both Indonesia and Malaysia are quite large, estimated to exceed US$ 25 billion between the two countries (Munira and Astuti 2019; and Tabung Haji, Malaysia 2020).

The Malaysian agency overseeing the funds (Tabung Haji) has a stated stewardship framework with a well-defined strategic asset allocation. The fund is well diversified and invests both domestically and internationally. It has also been a contributor to the strong capital market development in Malaysia (World Bank 2020c).

Meanwhile, there has been more debate about such investment in Indonesia, and it has not achieved the same level of impact. It may be possible for Hajj funds in Indonesia and perhaps in other countries with such funds (Maldives as one example; Muneeza and others 2018) to facilitate improved investments of these funds for local purposes that are still respectful of contributor motivations, while also providing improved outcomes.

The examples of Savings and Credit Cooperative Societies (SACCOs) in much of the world may also provide another example of an under-utilized potential resource. They play a large part in several African countries in mobilizing savings and providing credit to low-income customers. SACCOs also play a large part in the communities in which they operate. However, their informal nature makes it hard to truly understand and assess their size. In Kenya alone, however, they are estimated to exceed US$ 13 billion in total assets.

SACCOs already play a considerable part in enhancing the well-being of individuals across the continent. However, if just a small portion of their assets could be invested more profitably, with improved returns, that would be significant. An allocation of just 2 percent of their assets (equivalent to the allocation of some pension funds) toward productive, infrastructure-oriented assets with strong return prospects would benefit participants, as well as the communities/countries in which they live. This would be achieved by enabling further growth, leveraging what otherwise might be a partially hidden asset. Importantly, however, like the lesson of strong governance for local pension funds, it would be important to ground any such plans for expansion of SACCO investments with an enhanced regulatory framework (Wong and Lemus 2013).

This brief summary simply raises the topic of additional ‘hidden’ asset pools that bear further research and study. Policymakers should reflect on additional examples relevant to their own countries, and how those entities could also contribute further to sustainable development while furthering their stated missions.

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Conclusions

62. Leveraging local investors to support economic growth and development while securely meeting their promised liabilities can be achieved if the right governance and oversight are put in place. Multiple examples are presented in this paper regarding how to more effectively and efficiently utilize domestic capital in emerging markets, specifically by diversifying investments into long-term opportunities that can offer both improved returns, as well as contribute to the sustainable development of the local economies. It all begins with strong governance and oversight. Pension funds looking to diversify their investments into instruments with both return prospects, as well as secondary development-oriented goals, will require additional oversight skill on the part of the fund's governing body. Suitable investment vehicles typically need careful development, particularly for countries unused to these types of initiatives. As illustrated by several of the cases put forward in this paper, establishing a pool of investors, such as well-governed pension funds, actively seeking such opportunities frequently proves to be an important catalyst for such investment opportunities to be created, such as in the case of Malaysia.

63. The initial cases provide some evidence that having a specific mandate to invest in local development can be balanced with the primary goal of the funds to pay their beneficiaries. The EPF in Malaysia, having played a significant part in the development of capital markets in that country, is considering how it might increasingly contribute to social development. South Africa's GEPF allocates a proportion of its assets to improving the social conditions of the country's people. Other significant institutions in that country are also following suit. The Namibian regulator requires all pension funds to allocate a minimum percentage of assets to private equity initiatives, many of which contribute to sustainable development.

64. The demand for such local investments in new asset classes may grow by virtue of local funds cooperating and co-investing through partnerships with international investors, as well as ultimately through the growth of the local investor base. The challenge of insufficient governance is often accompanied by an attendant lack of capability and capacity in the local investment entities. In some cases, globally, this issue has been solved first by focusing on governance improvements. These are needed to support the secure diversification of any pension fund. However, they can also be helped by a pooling approach in which entities work together to assess potential new investments, sometimes with international partners. Examples of how focusing on providing long-term savings arrangements for those not currently served well by existing pension systems, such as workers in the informal sector, can also help to grow the local investor base.

65. The key lessons that have emerged from this assessment include the following. The last two lessons are particularly instructive with regard to furthering sustainable development:

- ***Governance matters:*** All investment arrangements should be underpinned by a commitment to best-practice standards of oversight, outsourcing, reporting and operational excellence. Many of the lessons that follow depend on this commitment to high-quality governance.

- ***Objectives matter:*** Actions should be formulated around a set of clearly stated goals. A common thread should bind these goals together. They should be expressed in clear language that is accessible to stakeholders of various kinds. Objectives should be supported by a set of measurable outcomes. Where a pension scheme is looking to broaden its objectives to include additional goals over and above returns for beneficiaries, those new goals should be secondary. In addition, they should be accompanied by clear, transparent measures of success.

- ***Measurement matters:*** The measurement of returns is important because it helps to address any concerns that investments that may have a secondary goal of targeting social objectives are inferior in terms of return prospects, or that they do so only at an unacceptable level of risk.

- ***Cooperation matters:*** Throughout many varied locations globally, local investors have faced the challenge of limited capacity and capability. As such, they are moving toward a relatively new solution focused on harnessing their joint capabilities to better invest in projects locally. Other countries can learn from the examples in Kenya, the Pacific Islands and South Africa by developing their own local investment opportunities more successfully. Additionally, the prospect of partnering with an IFI can increase chances for success with such an initiative.

- ***Leveraging and growing all sources of local investment matters:*** Countries should seek to identify and appropriately oversee all local investment entities that could potentially aid in driving progress toward sustainable development, as well as in meeting their beneficiaries' needs. Some examples included in this study were underregulated pension entities in South Asia and prospective new long-term savings schemes for the informal sectors. However, there are other possibilities as well.

66. This paper suggests that local sources of financing for development may be more available than is typically assumed. They can best be unlocked by first focusing on strong governance, regulation and supervision of these schemes. Pension funds will have an important role to play in this regard, including even those funds that are established as part of newly developed systems, such as the informal member schemes.

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