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OBSTACLES TO US PENSION FUND INVESTMENT IN AFRICA

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ABSTRACT

The Africa Finance Corporation (AFC) has been unable to raise capital from US pension funds despite its success in attracting investment from a diverse range of institutional investors. This article combines a case study of the AFC, consultations with senior-level professionals and experts, and a review of academic literature and industry reports to identify the reasons for the lack of investment in the AFC and the overall small share of investments in African entities by US pension funds. The research indicates institutional obstacles in the US pension fund investment ecosystem are mostly responsible for US pension funds forgoing investment in the AFC. More broadly, the research suggests inadequate returns, elevated risks, unsuitable investment characteristics, limited investment opportunities, higher costs, and poor liquidity are impeding investment in Africa. Efforts by development organizations and governments to accelerate capital market development, improve political and macroeconomic stability, and grow their capacity to deploy risk-sharing mechanisms could help increase US pension fund investment in Africa. US pension funds could benefit from reevaluating their investment policies, considering a larger allocation to fixed income investments abroad, and incentivizing investment consulting firms to build their capacity to provide investment advice for African markets.

Keywords SDGs; Africa; Investment; Development; Pension funds.

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Introduction

Imagine a regional development finance institution (DFI) with over 30 member countries. It touts strong capital adequacy levels, stable investment returns, and an investment grade credit rating of A3 by Moody's Investor Services (Moody's). It has developed a successful track record of issuing billions of USDs in Eurobonds and adopted an institutional structure geared to attract private investment. The DFI performed reasonably well in a global pandemic and emerged with consistent growth in its balance sheet to exceed USD 10 billion in assets. Yet, despite over USD 22 trillion in managed wealth, pension funds domiciled in the United States (US pension funds) have not made any investments in the DFI. How could this be?

The adoption of the United Nations Sustainable Development Goals (SDGs) served as a defining moment for development. The 17 goals and 169 targets represented a shift to a more holistic development agenda incorporating all nations (UNGA, 2015). Money alone would not accomplish the SDGs. Policy reforms, institutional improvements, macro-level systematic changes, and other actions that go well beyond the scope of this research paper are necessary to enable a pathway for sustainable development. Nevertheless, it was clear early on that the SDGs would not be accomplished without a significant increase in investment.

The United Nations (UN) originally approximated that investment would need to increase by USD 2.5 trillion per year to address the SDGs in developing countries (UNCTAD, 2014). The global pandemic upended the forecast, increasing the estimated financing gap to USD 4 trillion per year (UNCTAD, 2023a). In short, an already stalled development agenda met the pandemic and contributed to the global poverty rate growing for the first time in a generation (UN, 2021).

This relapse included the African continent, which experienced rising levels of extreme poverty, slowing foreign direct investment (FDI), and growing indebtedness (UNDP, 2022). Underinvestment is not new to the African continent. Figure 1 illustrates how FDI has historically lagged in African countries compared to other developing countries. Since 2007, FDI destined for Africa has remained relatively static, while FDI to other developing countries has grown by 84% (UNCTAD, 2023b). Investment originating from the United States (US) has been especially small with Africa representing 0.7% of total US direct investment abroad (BEA, 2023).

Official Development Assistance (ODA) by member countries of the Organisation for Economic Co-operation and Development (OECD) could play a role in closing the financing gap, but its potential for a meaningful contribution is small considering OECD countries would need to increase ODA by approximately 20-fold to meet the SDGs. More realistically, ODA is an unlikely source of increased finance when considering historical data of this measure as a percentage of gross national income (GNI) and future trendlines that indicate ODA will be in

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decline (OECD, n.d.). Beyond ODA, many areas of inquiry can be taken such as increasing domestic resource mobilization, easing capital flight, stopping tax evasion, creating a global tax body, and mobilizing private finance (Mawdsley, 2018). This article focuses on private finance due to the amount of wealth under private control and the potential impact a small fraction could have on financing development on the African continent.

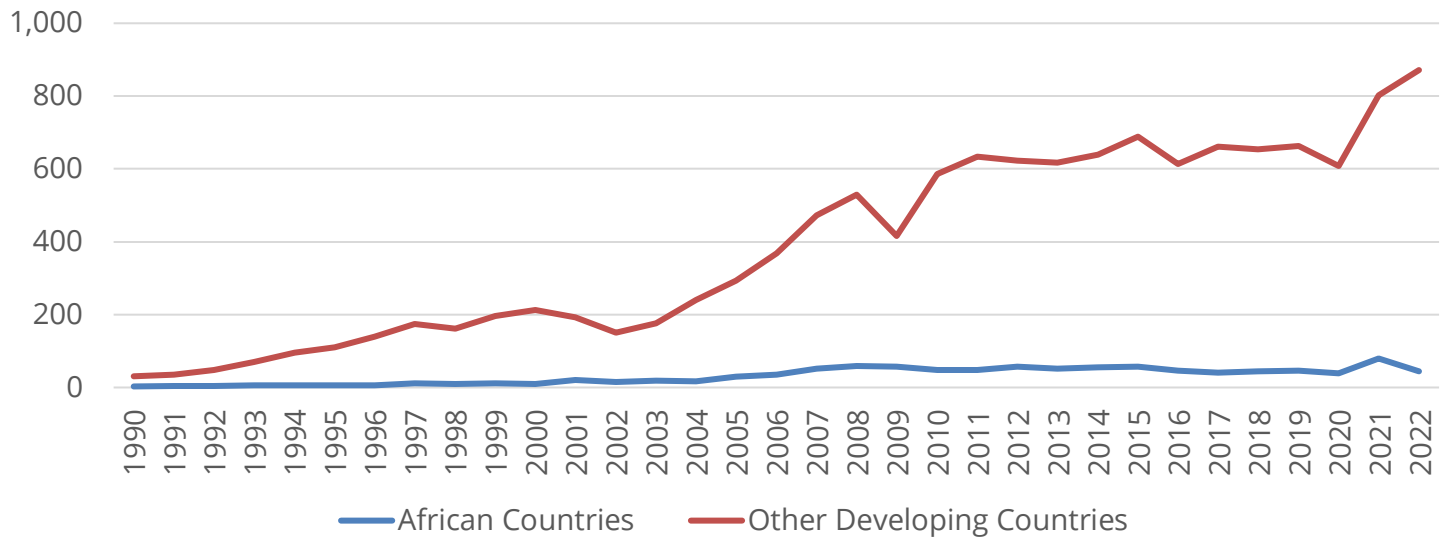

Figure 1: Annual Foreign Direct Investment (USD billion). Source: UNCTAD, 2023.

Global financial wealth has been measured to be roughly USD 275 trillion (BCG, 2024). Financial wealth is mostly managed by large organizations, which can be broken into asset owners and asset managers; they are collectively called institutional investors. Asset owners include banks, pension funds, insurance companies, sovereign wealth funds, endowments, foundations, and family offices. Asset managers (also referred to as investment advisors) invest wealth on behalf of asset owners and individual investors via their investment funds.

Given the breadth of investors and different geographical contexts, a credible analysis requires more specificity in the type and location of the investor. This paper centers on US pension funds given their collective total assets under management (AUM), few legal constraints to investing abroad, mandate to diversify holdings, need to increase investment returns, and relatively small investment levels in Africa (OECD, 2023b; Chan-Lau, 2005; PwC, 2020; Prosper Africa, 2021). The article focuses on one overarching question: What is preventing US pension funds from investing in African countries?

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1. METHODS

This paper employs a combination of research methods. A case study approach is utilized to anchor the paper. The Africa Finance Corporation (AFC) was chosen due to its unique characteristics. First, it has an investment grade credit rating and is one of the highest rated entities on the African continent. Second, it has successfully attracted significant external private investment from a variety of global investors except for US pension funds. Third, the AFC's presence on capital markets permitted independent analysis of market data. The case study is further strengthened by direct consultations with two AFC executives and a survey and open response questionnaire completed by AFC staff.

The case study is paired with qualitative consultations with 18 senior-level investment professionals in the US pension fund ecosystem and development finance experts. The interviews took place from February 2022 through February 2023, and the selection of participants was designed to achieve a balanced perspective from the different stakeholders. The participants included five officers at US pension funds, four officials at multilateral DFIs, three professionals at large asset management companies, two policy experts at multilateral organizations, a director at a large investment advisory firm, a vice president of a multilateral development bank (MDB), a policy advisor at a bilateral DFI, and a director at a prominent think tank focused on external investment in Africa. Lastly, the study incorporates publicly available information. This includes a literature review and synthesis of scholarly journal articles, industry and multilateral reports, business news articles, and press releases. Additionally, market data was retrieved and analyzed from the Bloomberg terminal to enhance the AFC case study.

There were two constraints to the research, which required tailored approaches. First, there was resistance by several investment professionals and executives at DFIs and MDBs to be formally interviewed due to concerns about how their contributions might affect their employer, clients, or career. As a result, consultations were conducted on a confidential basis to allow for participation and foster candid responses. While the consultative content included in this paper is sourced from the 18 people interviewed, informal discussions were held with other industry professionals who expressed an interest in participating but were unable to do so formally. These individuals comprised a dozen individuals including trustees at US pension funds, staff at US pension funds, legal advisors, and actuarial advisors. These discussions were utilized to protect against outliers influencing the conclusions and corroborate information collected in the interview process. As a result, the breadth of knowledge in this paper captures input from 32 professionals and experts (two AFC executives, 18 interviews, and 12 informal discussions).

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The second constraint is the lack of transparency by US pension funds in their investment holdings by country. In general, their reporting focuses on the distribution by asset class and US versus non-US holdings. To address this constraint, the research leverages public comments by industry leaders describing the share of aggregate investment holdings in Africa. The study further analyzes the assets of US pension funds that sufficiently disclose their investment holdings to estimate their share of AUM invested in Africa to test the validity of the public comments.

2. THE AFRICA FINANCE CORPORATION: A DESTINATION FOR GLOBAL INVESTORS

The African continent has expansive infrastructure requirements to meet the needs of its people and establish the building blocks for a prosperous century. The cost is estimated to be from USD 130 billion to USD 170 billion per year with a financing shortfall ranging from USD 68 billion to USD 108 billion per year (AfDB, 2018). It is projected that infrastructure investment will need to increase from the current average of 3.5% of GDP to 4.5% of GDP to close the financing gap (Lakmeeharan et al., 2020). Infrastructure investment falls largely in the public domain in Africa with state-owned enterprises (SOEs) and governments accounting for 95% of the share. Private finance has flowed to African infrastructure, but in limited amounts to Sub-Saharan Africa declining to just USD 5 billion in 2019 from USD 15 billion in 2012 (Eyraud et al., 2021).

2.1 Organizational Structure and Growth

The AFC was created in 2007 to help address the infrastructure deficit on the African continent. It was established by an international treaty as a DFI to "finance infrastructure, trade and development transactions in Africa" (AFC, 2020a). It relies on paid in-capital by shareholders, debt financing raised on international capital markets, and loans to finance its activities. The AFC has 37 shareholders in total. 46.3% of the ownership share is comprised of member countries and multilateral organizations. The remaining 53.7% is comprised of African financial institutions and other investors. (AFC, n.d.). Ownership is highly concentrated with primarily five shareholders owning 71.1% of the outstanding shares (AFC, 2023). The composition of owners is dominated by the Nigerian government and Nigerian financial institutions.

The AFC fulfills its mission by providing "project development, financial advisory and principal investing" to "fill key market gaps by participating across the entire project cycle and capital structure, ensuring that projects are well-structured and transactions reach financial close" (AFC, n.d.). It does so through advisory services, debt and equity investments, and treasury services to channel additional investment. It maintains a diverse portfolio of investments in toll roads, toll bridges, wind farms, power plants, seaports, telecommunication infrastructure, and more (AFC, n.d.).

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The AFC has invested in 35 African countries with total aggregate disbursements at over USD 10 billion since its inception (AFC, 2022b). Figure 2 illustrates the AFC's assets and equity by compiling data from annual reports published by the AFC dating back to its first report. The Figure highlights the AFC's rise measured by its assets, which are more than five times larger than they were a decade prior. It also implies an increase in financing beyond equity contributions.

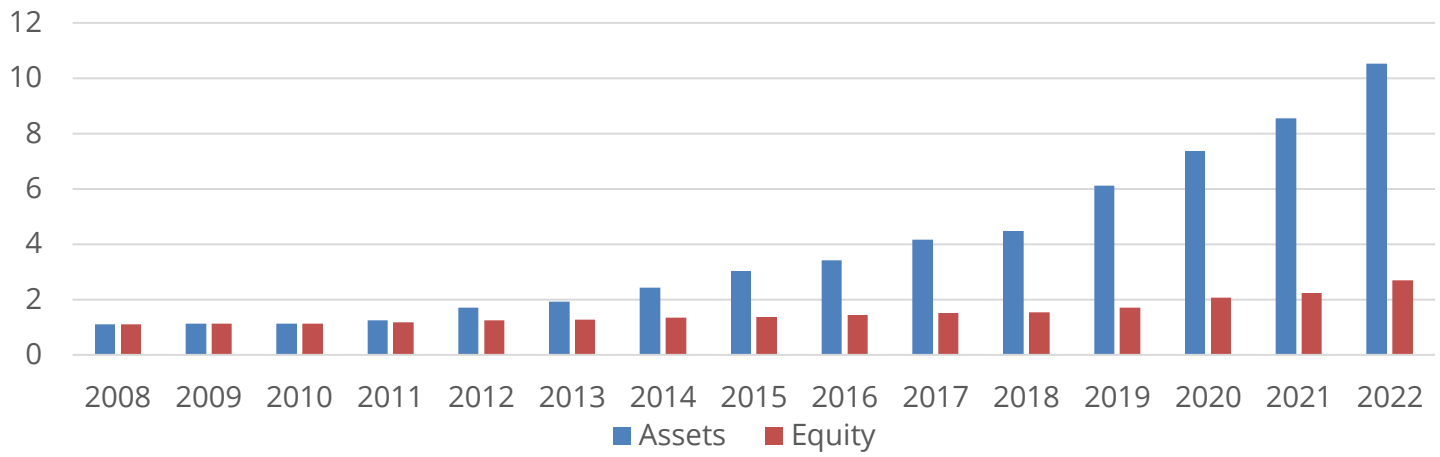

Figure 2: AFC's Assets and Equity (USD billion), 2008-2022. Source: AFC Annual Reports, 2010-23.

2.2 Creditworthiness and Investor Orientation

Moody's (2021) assigned the AFC an A3 credit rating. This is an investment grade credit rating, which fulfills an important investment threshold for large institutional investors. No sovereign country in Africa has a higher rating than the AFC. Further, it has a higher rating than countries in Latin America and Asia that raise significant amounts of capital from institutional investors in USDs such as Mexico, Panama, Peru, Colombia, Brazil, the Philippines, Indonesia, and Vietnam (S&P Global, 2022).

Moody's (2021) independent assessment of the AFC points to key strengths in its capital adequacy ratio, profitability, liquidity position, broadening access to finance, governance principles, and risk-taking policies. Its weaknesses remain the ability of its members to provide additional finance support in the event of poor asset performance. Overall, the AFC's credit health is good with Moody's (2021) expecting the AFC to "maintain its intrinsic financial strength, with strong capital adequacy and asset performance, liquidity and funding."

Senior AFC officials reported in consultations that they have been focused on creating investment characteristics that appeal to institutional investors to meet their investment preferences and fiduciary

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standards. They reinforced how the organization has continually improved its return-risk profile to attract institutional investors, emphasizing that it "generates of one of the highest returns among its peers (similar DFIs in Africa) and maintains a conservative risk management approach for US investors with diverse risk/return mix."

The AFC listed in their response to an open-ended questionnaire a variety of actions they have taken specifically to attract US investors. They reported that they provide dividends in USDs to mitigate conversion risks. They showcased that their governance framework permits investors to become board members, providing a potential role in decision-making and shaping the direction of the organization. The AFC emphasized that they offer a variety of capital instruments to meet the appetite of different US investors. The response further reinforced the AFC's consistent investment grade rating by Moody's and that they are exploring a second credit rating. The response highlighted that the infrastructure asset class is profitable and generates stable returns to match pension annuity and inflation risks. Lastly, the response noted the immunities and privileges they are granted by their member countries.

2.3 Fixed Income Investment

The AFC has attracted external investment from around the globe, which the organization has recirculated into infrastructure development projects. This includes debt financing from insurance companies and asset managers in the US as well as the US government. The AFC mostly borrows to finance its mission with long-term debt amounting to 62.7% of its total capital (Bloomberg, 2022). The AFC relies primarily on bonds issued in debt capital markets and loans to a lesser extent. The AFC leverages its capital reserves and backing by its shareholders to borrow at lower yields and longer tenors. Figure 3 illustrates the make-up of the AFC's outstanding debt that has been registered and tracked on Bloomberg. The largest share is in USDs amounting to 89.4% of the total, with the remaining comprised of 7.7% in CHF, 2.7% in EUR, and 0.2% in JPY (Bloomberg, 2022).

Security Description	Currency	Amount (USD million)	Coupon	Maturity
Senior Unsecured Loans (6 Issues)		**981**		
AFRFIN TL UNSEC	USD	50	Unknown	7/29/2030
AFRFIN TL UNSEC	USD	150	Unknown	6/22/2031
AFRFIN TL A UNSEC	USD	233	Unknown	9/6/2022
AFRFIN TL B UNSEC	JPY	7.87	Unknown	9/6/2022

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AFRFIN TL UNSEC	USD	140	Unknown	11/14/2022
AFRFIN TL A UNSEC	USD	400	1.828	12/15/2024
Senior Unsecured Bonds (16 Issues)		**3,749**		
AFRFIN 3 7/8 04/13/24	USD	500	3.875	4/13/2024
AFRFIN Float 06/10/22	USD	25	1.653	6/10/2022
AFRFIN 3 1/8 06/16/25	USD	700	3.125	6/16/2025
AFRFIN 1 3/4 05/17/41	EUR	37.49	1.75	5/17/2041
AFRFIN 1 5/8 11/17/38	EUR	16.07	1.625	11/17/2038
AFRFIN 1 5/8 12/02/47	EUR	16.07	1.625	12/2/2047
AFRFIN 1.35 08/19/31	EUR	42.84	1.35	8/19/2031
AFRFIN 1.3 08/21/34	EUR	16.07	1.3	8/21/2034
AFRFIN 2 7/8 04/28/28	USD	750	2.875	4/28/2028
AFRFIN 2.9 07/21/31	USD	50	2.9	7/21/2031
AFRFIN 2.87 08/13/31	USD	50	2.87	8/13/2031
AFRFIN 0.77 09/01/23	USD	30	0.77	9/1/2023
AFRFIN 1.205 09/30/25	CHF	156.61	1.205	9/30/2025
AFRFIN 3 3/4 10/30/29	USD	500	3.75	10/30/2029
AFRFIN 0.5225 12/20/23	CHF	208.81	0.5225	12/20/2023
AFRFIN 4 3/8 04/17/26	USD	650	4.375	4/17/2026

Figure 3: AFC Outstanding Debt. Source: Bloomberg, 2022.

The Bloomberg database lists registered bond holdings, so it is not feasible to identify every bondholder from public sources. Nevertheless, press releases and analysis of registered holdings on Bloomberg can provide a relatively clear picture of the investors. The USD 750 million issuance due in 2028 was "3.5 times oversubscribed at approximately US$2.6 billion, with funds coming from more than 200 investors, across the UK (32%), Continental Europe (23%), Middle East (22%), Asia (13%), and the US/Americas (10%)" (AFC 2021). The USD 650 million issuance due in 2026 was allocated to "investors in Europe (29%), United Kingdom (21%), United States (20%), Asia (16%) and the Middle East (1%)" (AFC, 2019). Figure 4 details the largest investors that have registered securities on Bloomberg (2022), which skew to investment advisors and then to banks and insurers.

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Holder	Amount (USD)	Share (%)	Investor Type	Country
Massachusetts Mutual	100,115,000	1.87	Insurance Company	US
Credit Agricole	80,019,000	1.49	Bank	France
Invesco Ltd	64,773,563	1.21	Investment Advisor	US
Credit Suisse Group	56,938,768	1.06	Investment Advisor	Switzerland
UBS AG	54,969,422	1.02	Investment Advisor	Switzerland
Deutsche Bank AG	40,572,996	0.76	Investment Advisor	Germany
Banque Lombard Odier	29,855,136	0.56	Bank	Switzerland
JPMorgan Chase	27,156,000	0.51	Investment Advisor	US
Danske Bank	25,874,169	0.48	Bank	Denmark
Barings LLC	23,447,000	0.44	Investment Advisor	US
abrdn plc	22,592,000	0.42	Investment Advisor	UK
Principal Financial	22,200,000	0.41	Investment Advisor	US
New York Life	18,020,000	0.34	Insurance Company	US
KGI Securities	17,934,387	0.33	Investment Advisor	Taiwan
BlackRock Inc.	16,606,610	0.31	Investment Advisor	US

Figure 4: Largest Registered Bond Investors. Source: Bloomberg, 2022.

While more costly and time consuming to issue, an international issuance with a 144a private placement exemption permits qualified US investors to participate (Baker McKenzie, 2020). An analysis of registered data from AFC's 144a private placements in 2019 and 2021 indicates significant interest from US institutional investors amounting to USD 113 million in registered holdings (Bloomberg, 2022). The breakdown by investor type for the two 144a issuances from registered data compiled from Bloomberg (2022) indicate a balanced mix of insurance companies (47%) and investment advisors (53%).

The distribution of loans is not easily identifiable since holders are not registered in Bloomberg. Nevertheless, press releases and media reports identify the AFC's primary lenders from a macro perspective. The USD 400 million loan secured in 2022 for the AFC was syndicated to banks in South Africa, the United Arab Emirates (UAE), South Korea, the United Kingdom (UK), and China (Benson, 2022). Loans also came from governments as exemplified by the USD 100 million line of credit by the Export-Import Bank of India and USD 250 million loan from the US International Development Finance Corporation (Businesswire, 2021a; Businesswire, 2021b). These reports indicate loans are principally made by governments, government-back institutions, and banks. Overall, evidence of fixed income investment illustrates diversity in geography and type of asset owner.

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3. US PENSION FUNDS: A LARGE POTENTIAL SOURCE FOR NEW INVESTMENT

Pension funds are organizations that collectively invest retirement savings on behalf of future pensioners in defined benefit retirement schemes. The largest concentration of pension fund wealth is in the US where pension funds hold USD 22.6 trillion in AUM, 58.7% of the global total (OECD, 2023b; OECD, 2023c). Figure 5 ranks the largest US pension funds by size.

Rank	Sponsor	AUM (USD million)
1	California Public Employees (CalPERS)	494,539
2	California State Teachers (CalSTRS)	312,150
3	Ney York State Common	267,756
4	New York City Retirement	266,702
5	Florida State Board	199,041
6	Texas Teachers	196,727
7	New York State Teachers (NYSTRS)	144,396
8	Wisconsin Investment Board	140,923
9	Washington State Board	134,977
10	North Carolina Retirement System	121,336

Figure 5: Ten Largest US Pension Funds. Source: P&I, 2022.

Beyond AUM, US pension funds have several relevant characteristics that make them a potential candidate for investment in Africa. First, they have incentives to increase returns on investment and mandates to diversify their holdings. Pew (2022a) estimates that public pension funds in the US are 74% funded – that is they will only be able to provide $0.74 on the dollar of their promised benefits on average. As a result, US pension funds are motivated to increase rates of return to meet future payments to retirees, and the African continent could be a vehicle to achieve this objective. US pension funds also are accustomed to broadening asset classes and geographies of investments to manage investment risk. Fundamentally, diversity of investments is a part of their institutional mandate (Jordan, 1999). US pension funds have equity positions making up 41% of their portfolios and investments outside of the US amounting to 18% of AUM (Milliman, 2023).

US pension funds have demonstrated a commitment to invest in new asset classes by their shift from a traditional equity and bond mix to alternative investments in search of higher returns and greater diversification (PwC, 2020). This has involved a growing share of investments in alternative assets, which have evolved from the early 2000s to "include hedge funds, commodities, private equity, currency and tactical asset allocation overlays, commercial loans, infrastructure investments, forestry products, microfinance and other niche areas"

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(Inderst, 2009). Milliman (2023) estimates that 34% of pension fund portfolios are made up of alternatives mostly in private equity, real estate, and hedge funds. Pew (2022b) reinforces this finding by noting that most public pension funds have at least 65% of assets invested in stocks and alternatives; this is a transformational shift from the late 1950s when over 90% of assets were invested in fixed income and cash.

Moreover, US pensions have few legal constraints to invest outside the US. PwC (2020) finds that "the US does not set any quantitative limit on overall foreign investments or any specific asset classes for pension funds." The OECD (2023a) validates this fact by concluding that US pension funds have no direct limitations on foreign investments. This is reinforced in scholarly research indicating "investment regulation does not appear to be a major impediment to investing in emerging market securities" (Chan-Lau, 2005).

Lastly, US pension funds invest a small share of their portfolios in Africa. Industry experts estimate that US pension funds collectively invest less than 1% of their AUM in Africa (Prosper Africa, 2021; Arvedlund and Williamson, 2023). Given the absence of publicly available aggregate data on US pension fund investment in Africa and the relatively few US pension funds that report individual investment holdings, it is not possible to provide a precise number. However, there are indications that large US pension funds are significantly below the 1% estimate. For example, the Massachusetts Pension Reserves Investment Management Board (PRIM) confirmed it has "approximately $100 million, or approximately 0.1% of fund assets, invested African countries and companies" (Arvedlund and Williamson, 2023).

An in-depth analysis of CalPERS (2021), CalSTRS (2022), and NYSTRS (2022) was undertaken for this paper to illustrate other examples, since they provide a rare amount of disclosure on investment holdings to estimate the share of AUM in Africa. The analysis indicates equity investment in Africa is predominately in South Africa. The largest share of debt investment is also in South Africa, but fixed income holdings are also found in Nigeria, Ivory Coast, Kenya, Egypt, and Ghana. The share of total investments in African countries and companies is small when compared to their overall size. The analysis estimated that CalSTRS and NYSTRS allocate no more than 0.25% of their investment holdings in Africa. CalPERS was lower with African investments estimated to be no more than 0.2% of their AUM.

Consultations with investment officers at US pension funds indicated smaller US pension funds predominately invest passively through asset managers, which could alter their investment percentage in Africa. The Municipal Employees' Retirement System of Michigan (MERS) was selected as an example of a smaller US pension fund at the upper end of the investment range in Africa. MERS (2022) had USD 11.5 billion in AUM with 34.64% invested abroad, which is significantly higher than the 18% average noted earlier. Once applying country allocations to the benchmarks MERS references, it is estimated that MERS invests 1.6% of its AUM in Africa (MERS, 2022;

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Blackrock 2022a; Blackrock 2022b; MSCI 2022b). Thus, some smaller US pension funds may be investing more in Africa than larger US pension funds. Nevertheless, once applying a weighted average, the analysis supports the finding that less than 1% of US pension funds' assets are invested in Africa.

4. IMPEDIMENTS TO US PENSION FUND INVESTMENT

Despite the investments by other types of institutional investors, US pension funds have not invested in the AFC. Bloomberg (2022) data indicated no US pension funds hold AFC bonds. Further, AFC officials stated in a 2022 questionnaire response that they have received no direct debt or equity investments by US pension funds. The AFC also attracts investment alongside its infrastructure investments or when it exits or refinances infrastructure investments; here too, the questionnaire indicates that AFC officials are not aware of any investment by US pension funds investing in these situations either. It cannot be confirmed that US pensions are indirectly investing in the AFC through investment funds offered by asset managers. Regardless, given that AFC bonds would be a small share of securities in a fund, it is reasonable to conclude that US pension fund investment remains effectively absent.

4.1 Explanations Expressed in the Literature

There is a literature gap in scholarly journals as well as multilateral and industry reports focusing specifically on impediments for US pension funds investing in African countries. However, the available literature identifies several reasons for the lack of private investment in low-income countries more generally. Collier (2013) suggests that higher perceived risks in the least developed countries have stymied private investment. More comprehensively, Zhan and Santos-Paulino (2021) provide a summary of the available literature related to private finance for the SDGs in developing countries, finding that the primary impediments are: 1. "market failures and a lack of a sound system for corporate disclosure of environmental, social, and governance performance, misaligned incentives for market participants, and start-up and scaling problems for innovative financing solutions;" 2. "entry barriers, inadequate risk-return ratios for SDG investments, a lack of information and effective packaging and promotion of pipeline bankable projects, and a lack of investor expertise;" and 3. "persistent weak absorptive capacity in some developing countries, social and environmental impact risks, and the need for stakeholder engagement and effective impact monitoring."

The literature focused on obstacles to private investment specific to Africa offer similar as well as unique obstacles. Collier (2014) points to the lack of standardization and insufficient investment returns as obstacles to attracting private investors. For African infrastructure investment, bottlenecks in the project cycle, capacity constraints, and costs of project preparation are impeding the availability of investible projects (OECD/ACET,

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2020; Lakmeeharan et al, 2020; Mayaki, 2019). Analysis by the IMF (2021) found that investment returns in Sub-Saharan African (SSA) countries "are not always sufficient to compensate for the higher risk. Specifically, SSA returns have fallen significantly from a peak in the 2000s, while risks identified by financial investors, including macroeconomic volatility and markets' illiquidity, are perceived to be higher than in other regions and have not diminished markedly over the same period."

Elevated risks also impede private investment in Africa. A survey of institutional investors found the top risks related to private investment in Africa are project risk, exit risk, and macroeconomic risk (GIIN, 2020). Exit risks in Africa are multifaceted, including 1. "relatively underdeveloped and illiquid financial markets;" 2. "weaknesses of the judicial, policy, and regulatory frameworks;" and 3. "capital account restrictions on financial outflows" (IMF, 2021). Additional obstacles in Africa include insufficient data, costly due diligence, and inadequate investment size of African-focused private equity funds (Dupoux et al, 2016; Schlapinski, 2018).

4.2 Explanations Provided by the AFC

AFC officials shared that they have directly engaged with several US pension funds. The overarching feedback they received from US pension funds is that Africa is not a region they focus on or does not align with their desired investment profile. Specifically, the AFC reported that the most common reasons US pension funds provide when declining to invest in the AFC include: "1. Not having an Africa Strategy; 2. Not meeting their minimum credit rating requirement; 3. Africa was not a focus territory; 4. Africa does not fit within their investment profile; and 5. No exit or secondary market for shares or investments."

Officials at the AFC conveyed that the most prominent concern centered around the perception of risk. The AFC sees US pension funds looking for stable investments to meet their long-term liability matching needs. The AFC found that the perceived higher risk serves as a setback for US pension funds from targeting Africa as a potential investment destination. Consultations revealed the AFC is mindful of the risks associated with infrastructure investments on the African continent and the importance of a stable macroeconomic environment, political stability, and investment-friendly legal and institutional frameworks. As a result, the AFC noted that multilateral institutions could provide risk mitigants (insurance or co-investment) to ensure an appropriate risk-return mix. Regardless, the AFC officials pointed out that these perceived risks did not deter other US domiciled institutional investors from investing in AFC bonds or Moody's assigning an A3 rating.

The survey completed by AFC officials included a Linkert scale of obstacles the AFC sees as impeding US pension fund investment on the African continent more broadly. They were split into institutional and investment specific categories. The AFC identified each impediment on the following scale: no obstacle, small obstacle, medium obstacle, and large obstacle. Figure 6 summarizes the results.

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Degree	Investment Level	Institutional Level
Large	• Cost of risk mitigation tools • Credit rating of issuers • Inability to mark-to-market (value) investments • Tenor of fixed income investments • Small deal size • Level of risk • Lack of investment funds offered by asset managers	• Investment policies • Investment choices made by other asset owners • Advice provided by investment managers • Advice provided by legal advisors • Advice provided by external investment advisors
Medium	• Lack of government support (guarantees or insurance) • Expected ROI too low • Track record of issuing securities • Inadequate deal flow • Lack of opportunities for direct investment	• Investment preferences by full-time executive staff of US pension funds
Small	• Securities not being registered in the US or Europe • Inability to invest in securities issued in local currency	• Investment preferences by elected political officials • Decisions or preferences by the Trustees
No		• State Laws/Regulations • Federal Laws/Regulations

Figure 6: Investment Obstacles Identified by the AFC. Source: Author's Summary of AFC Survey, 2022.

The AFC does not see the legal environment in the US preventing US pension funds from investing in Africa. Instead, the AFC suspects that the investment policies are the key obstacle as well as the actors who shape investment decisions such as the full-time executive staff, external advisors, and investment managers. The AFC further recognizes the importance of precedents set by the largest US pension funds. Several obstacles are mentioned in the investment-specific category. The most prominent included impediments such as low or no credit ratings, cost of risk mitigation tools, short tenor of debt instruments, small deal size, level of risk, inability to value holdings, and the lack of investment funds that capture investment in Africa.

The AFC concluded that institutional obstacles were the largest barrier for their circumstance. For example, none of the investment impediments listed in Figure 6 would likely apply to the AFC except for potentially the return on investment (ROI) being too low for the level of risk. This is different for other investments in Africa where investment specific impediments are much more of a deterrent.

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4.3 Explanations Provided by Investment Professionals and Experts

Consultations with senior level professionals and experts add an additional layer to the inquiry. Most interviews centered on the risk-return dynamic on the premise that US pension funds expect returns to mirror the elevated risks involved with investing on the African continent. As one US pension fund investment officer highlighted, "returns are a must." The same individual found that the internal rate of return (IRR) for opportunities in Africa is often too low, concluding they are "not blowing the lights out." Returns must beat similarly risked investments available in more established markets to be considered for investment. Several experts suggested US pension funds see expected returns falling below what is necessary for the risk.

The IRR challenge is not without data to support that conclusion. For example, the MSCI Frontier Markets equity index has significantly underperformed the MSCI All World equity index (MSCI AWI) earning a 10-year annualized return of 3.58% versus 8.54%, respectively. African countries included in the frontier index include Burkina Faso, Benin, Guinea- Bissau, Ivory Coast, Kenya, Mauritius, Mali, Morocco, Niger, Nigeria, Senegal, Togo, and Tunisia. MSCI AWI only includes South Africa (0.45% allocation) and Egypt (0.01% allocation) from Africa (MSCI 2022a; MSCI 2022b). Emerging market fixed income funds have also been hurt by a rising global interest rate environment and macroeconomic difficulties more generally (Blackrock, 2022a).

Some experts felt the perceived risks of investment on the continent were higher than the actual risks when measured objectively. This negatively affects investment and leads to fewer investment opportunities meeting their criteria. One expert made the risk-return importance unmistakable by stating "investment returns relative to the risk are paramount; everything else is secondary." Another expert highlighted local institutional impediments (described as "non-investment risks") in African countries are the source of much of this elevated risk – elements such as weak rule of law, political instability, and uncertainty around monetary and fiscal policy weighed heavily on risk calculations.

Deal flow was mentioned by DFI experts as a constraint. They expressed that not enough financing opportunities are being originated from African countries that had investible characteristics for US pension funds. Another impediment was in the investment policies or mandates – Africa was simply not the focus for their investment priorities, and despite being presented with a promising investment opportunity, US pension funds would not consider it. Overall, many specific investment impediments were highlighted by consultations with experts and investment professionals. Figure 7 lists them broken into four categories.

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Unfavorable risk-return dynamics	• Inconsistent investment returns ("choppy performance") • Lower returns than similarly risked investments • The cost and/or difficulty of hedging • Fees charged by local private equity/debt funds
Liquidity challenges	• Immature security exchanges limiting opportunities for equity investments • Inability to exit investments • No secondary market • Inability to mark-to-market to report a market value
Unsuitable investment characteristics	• Credit ratings too low or credit standards not being met • Lack of Africa-focused investment funds • Currency of the security • Currency of the income flow supporting the security • Small size of investible transactions or investible funds • Lack of instruments to channel larger investment allocations
Local capacity constraints	• Small market capitalization of local markets • No municipal bond market • Weak balance sheets of SOEs • The lack of domestic yield curve, especially longer tenors • Insufficient capacity of firms to absorb new investment • Companies not being listed on exchanges

Figure 7: Investment Impediments Identified in Interviews. Source: Author's Summary.

One overarching theme emphasized by the senior officer of one of the largest US pension funds was the need for a capital market system that supports equity investment. US pension funds invest significantly more in equity than debt outside of the US. To increase investment in equities, it is imperative that capital markets mature enough to meet the standards established by indexing firms, especially to allow sufficient liquidity. The expert noted that there is no quick fix to this dilemma.

Two pension fund investments officers emphasized the need for increased opportunities to invest in private equity and private debt on the African continent. They stressed that private funds focused on Africa are too small and several firms in the market have yet to develop a track record that meets their standards. They also highlighted that the fees are too high relative to the investment size. Regardless, the investment officers remarked they are open to these firms, but when comparing returns and fees in developed markets, the private market in Africa underperforms and does not warrant investment. Two of the asset managers interviewed who

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focus on institutional sales countered this argument, though. Their firm established a private debt fund that has significant exposure in Africa, but they reported difficulties generating interest from the US pension funds they work with.

Bias was explored in several consultations. For example, at the end of one consultation, an investment officer asked: "have you considered the effect of bias?" None of the investment officers consulted in this study detected bias in their organizations, but they suggested it could be present at other pension funds or within the ecosystem of actors that are critical to the investment-making process. Bias was also brought up in a consultation with a director at a prominent think tank who observes private sector participant interactions with executives of African companies. The director shared that there does not appear to be the same level of legitimacy given to African business leaders compared to executives in other regions of the world.

Investment consulting firms were identified in consultations as a likely impediment to investment in Africa. The rationale was explained to be one of a lack of a business incentive to employ consultants able to vet investment opportunities. That is, there was not enough interest or market size to justify the investment in staff and resources. The director of the investment consulting firm interviewed for this study was not aware of bias at investment consulting firms, but the director thought bias may be expressed by individuals within US pension funds pointing out that some individual trustees on pension fund boards have country or regional preferences that can affect investment allocation decisions.

The senior officer at a large US pension fund consulted for this study did not think bias was a factor at US pension funds. Instead, the official attributed it to US pension funds being unfamiliar with African markets compared to other regions of the world. Further, the senior officer emphasized that indexes, like the MSCI AWI, dictate their investment allocation to Africa. The senior officer suggested exploring the methodology used by MSCI to categorize countries as emerging or frontier as well as the relative amount allocated to African countries. This was reinforced by the director of the investment consulting firm who suggested focusing on MSCI's methodology.

The lack of familiarity with the African market was identified in several interviews. As the most striking example, an executive at a multilateral DFI involved with attracting private investment to Africa noted that private investors are less resistant to investment opportunities in Latin America and the Caribbean (LAC) compared to Africa. This was the case even when considering opportunities in countries in the LAC region that face similar investment, macroeconomic, and political risks as African countries.

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Conclusion

US pension funds are not investing on the African continent in a meaningful way, even when presented with compelling investment opportunities like the AFC. This study has identified investment returns compared to risks as a primary factor when US pension funds make asset allocation decisions. Consultations indicated that African investment opportunities are often not producing high enough returns, consistent enough returns, or at the necessary scale to meet the needs of US pension funds. The study also indicated that perceived risks might be higher than actual risks, which inadvertently impedes some investments. It also highlights that non-investment risks are impeding investment in Africa with currency volatility, political risks, and unpredictable changes in government policies as factors. Further, it identified the impact of indexing firms and decisions by investment consultants as contributing factors to lower investment levels in Africa.

The AFC provided an ideal vehicle to explore this research question given its lower risk profile and success at attracting an array of institutional investors. The AFC showed how institutional rules at US pension funds play a significant role in preventing investment in Africa. Their input identified investment policies and investment strategies that omit Africa with rationales provided to the AFC such as "not having an Africa strategy" or "Africa was not a focus territory." AFC further illustrated that decisionmakers that set investment policy have significant influence when determining rules that affect investment in Africa.

The AFC's survey response identified leading investment impediments in Africa include risk-return imbalances, small deal size, the lack of investment funds, short tenors, the inability to mark-to-market investments, the cost of risk mitigation tools, and low credit ratings. The paper explores the potential for bias or regional preferences having an impact on African investment. Interviews indicate this may be a factor in explaining why some US pension funds have been unwilling to invest in the AFC and keep allocations small for African governments and corporates; however, it was not found to be a primary impediment.

Evidence in this paper provides a window into potential strategies to improve investment by US pension funds in Africa. Investment policies by US pension funds could benefit from a reassessment by trustees and public officials to ensure that they are not excluding Africa as a potential market. US pension funds allocate a far greater share of their assets abroad to equities than fixed income. As a result, US pension funds could benefit by considering a larger allocation to fixed income abroad to improve their ability to invest in African markets. Further, international and domestic support to foster equity capital market development on the African continent could help increase US pension fund investment, especially if these exchanges are included in MSCI

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indexes. MSCI and their indexing peers could also consider how their categorization and indexing conventions are steering investors away from Africa and adjust without compromising their investment principles.

Efforts by stakeholders to provide more investment options in the alternatives space (i.e. private equity, venture capital, and/or private debt) could help prompt increased investment in Africa. MDBs, DFIs, and governments could also do more to increase their support of securities originated on the African continent by reducing risks and/or subsidize returns to bring more investments into the risk-return balance through investment vehicles and guarantee programs. This could also be achieved by supporting efforts to improve stability in the policy and macroeconomic environments in African countries. Further, lessons learned from the AFC could be shared amongst African corporates to improve their prospects for attracting institutional investment.

A concerted effort by institutional investors to incentivize investment consultants to build their capacity in Africa could deliver meaningful change. Further, efforts by asset managers to engage with US pension fund investment officers and board members could facilitate increased investment allocations. Lastly, more awareness of the investment impediments and knowledge of investment opportunities in organizations like the AFC could help break down barriers that have led to an overestimation of African risk compared to other developing regions.

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