Saving for the golden years - African style

While Africa's youthful population and growing middle class are generally a big plus when it comes to investment potential, but what happens when this cohort gets old? Will the continent's pension market be able to cope?

Gerald Gondo, executive, business development - Africa, RisCura

Africa's youth will not only age, but will also live longer. According to United Nations research, Africa is projected to gain nearly 11 years of life expectancy by 2050, reaching 71 years in 2045-2050.

"Developing more efficient pension systems across the continent is crucial and we need to increase ongoing savings contributions for the development of institutional investment and investors in Africa," says Gerald Gondo, one of the authors of RisCura's *Bright Africa report for 2018*.

"The symbiotic relationship between pension systems (suppliers of savings) and institutional investors (investors of savings) allows for the creation of assets that should safely and sustainably fund the retirement goals of African savers," he says.

Harnessing Africa's informal savings

Roughly 70% of Africa's workers are employed in the informal sector. This has limited the size of traditional pension funds – resulting in low levels of pension coverage. Formal pension funds are unable to cater for low incomes, which are irregular as many workers are seasonal and migrant.
"Stakeholders in African pensions systems, including policy-makers, pension practitioners, and development finance institutions, need to embrace this reality and enable savings for this group," says Gondo.

The pension systems of Nigeria and Kenya are already embracing alternative forms of savings. In Nigeria, the Micro Pension Plan is designed to cover small-to-medium sized enterprises, self-employed Nigerians and the broader informal sector. As at the end of 2016, there were an estimated 38-million potential contributors to the plan. The Nigerian pension industry's strategic objective is to cover 30% of the country's working population by 2024, which will only be achievable by reaching out to the informal sector.

Kenya's Mbao Pension Plan also targets workers in the informal sector, who run micro, small and medium sized enterprises in Kenya. Under Mbao, members must make a daily minimum contribution of KES. 20 ($0,20) using their mobile phones. Members can make their payments through M-Pesa and Airtel Money transfer services in real-time, 24 hours a day, and from anywhere within the mobile phone network coverage.

“These plans show the opportunities that mobile phone penetration offers for pension funds,” says Gondo. “They also reflect international trends, where digitally-integrated payment, administration and investment functions allow greater flexibility in participation as well as lower costs.”

Pension fund asset allocation

In most OECD and many non-OECD countries, bonds and equities remain the two predominant asset classes for pension funds. While globally there is a larger allocation to equities (45%), the picture in Africa is more disparate.

Asset allocation in sub-Saharan Africa has favoured equities, which have shown a steady increase enabled by the development of capital markets and regulatory change. In Nigeria and East Africa, asset allocation is dominated by fixed income allocations, which predominantly constitute local bonds.

When viewed alongside the high asset-growth in these regions, it reflects both regulation and a lack of alternative local investment opportunities. “This highlight’s one of the key challenges pension funds face: identifying enough appropriate, local investment opportunities to invest ever-increasing contributions,” says Gondo.

Local regulation remains one of the main drivers of asset allocation. “There are often significant differences between the regulatory allowances for pension funds, size of local capital markets and actual portfolio allocations between regions,” he says.

This is due to several factors, including familiarity with alternative asset classes, such as private equity, development of local capital markets and the availability of investment opportunities.

“In many countries, assets are growing much faster than products are being brought to market, which limits investment opportunities if regulation does not allow for pension funds to invest outside of their own countries,” says Gondo.

Addressing the shortage of investment opportunities

One way for pension funds to address the shortage of investment opportunities is through investment into alternative assets classes. This kind of investment in Africa has historically come from developmental finance institutions (DFIs), but pension funds are slowly joining in. As pension assets continue to grow and international development assistance decreases, African pension funds have a pivotal role to play in facilitating inclusive growth and social stability.

“Local institutional investors lend credibility and often serve as a catalyst for greater external interest. Local investors also allow global peers to benefit from local knowledge and networks,” says Gondo.

South Africa, Botswana, Nigeria and Namibia have led the way in investing in alternative asset classes such as private equity. South African pension funds, for example, have been active in African private equity investment, both locally and across the continent, enabled by recent regulatory change.

“Regulatory changes are taking place across the continent and the deregulation of prescription will unlock capital to flow where needed in Africa. Looking specifically at private equity, if African pension funds are to take the lead from DFIs in further deepening the private equity industry, capital must be allowed to seek the most compelling investment opportunities,” Gondo says.