

Pension Funds and Private Equity in Nigeria





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Foreword

We are delighted to present the inaugural Pension Funds and Private Equity Report, produced in partnership with the Pension Fund Operators Association of Nigeria (PenOp). At AVCA, our mission is to champion private investment in Africa, educating and equipping stakeholders within our industry with valuable insights to support the investment ecosystem. This report exemplifies our commitment to providing topical, independent, and thoughtful research to the industry. Our hope is that this report serves as a practical exposé for industry professionals on the factors driving Nigerian pension funds' views of investing in private equity.



Abi Mustapha-Maduakor
Chief Executive Officer, AVCA



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Chief Executive Officer, PenOp

Nigerian pension funds have grown exponentially in both size and value in recent years and have a significant role to play in the sustainability and development of local capital markets. AVCA's partnership with PenOp focuses on providing capacity building, dialogue, and connectivity opportunities to empower and enable key stakeholders to mine the capital-raising depths this growth in pension assets represents for the private equity industry in Nigeria. Part of AVCA's mission to unlock domestic capital involves demystifying the asset class. Our collaboration with PenOp will enable AVCA to equip Nigerian pension funds with the resources they need to achieve superior returns by investing in the continent's growing businesses.

As Nigeria's private equity landscape continues to evolve, more emphasis is being placed on how best to invest in this unique landscape where tremendous growth opportunities are intertwined with a fair amount of macroeconomic uncertainty. Although pension funds acknowledge the need for diversification into alternatives, and the inherent opportunities private equity presents for this purpose, we have yet to see much uptake of pension investment in private equity locally. Increasing interest in the asset class underscores the need to analyse the perceptions and concerns of institutional investors to promote an open dialogue on Africa's unique business environment.

Our sincere appreciation to the pension funds and fund managers that participated in this report, as well as the AVCA members that supported this important initiative. We look forward to continuing our research and advocacy on the impact pension fund investment can have in private equity, and by extension in accelerating local economic growth.



Executive Summary

The Pension Funds and Private Equity Report, produced in collaboration with the Pension Fund Operators Association of Nigeria (PenOp) examines the plans, preferences, and expectations of Pension Fund Managers operational in Nigeria. This publication marks the launch of a wider partnership between AVCA and PenOp investigating and assessing the role of Nigerian pension funds in empowering local investors in Nigeria's private equity industry. As at December 31st 2020, the Nigerian pension industry had committed ₦35.48 billion (over US\$92 million) to private equity funds, the equivalent of 0.29% of total pension fund assets¹. However, the potential for pension investment in private equity is enormous and far exceeds current allocations being made to the asset class. Portfolio ceilings on the investment of pension funds in private equity (5%) means that ₦615 billion (over US\$1.5 billion) of pension fund assets may be unlocked to invest in private equity funds.

¹ National Pension Commission, 2021. *2020 Annual Report*.

Given the crucial role of domestic capital in accelerating economic growth, the AVCA-PenOp partnership hopes to enlighten Nigerian pension funds on the opportunities for portfolio diversification that the asset class offers, ultimately galvanising more domestic capital for PE in Nigeria. To that end, the study discusses the PE landscape on the continent, analysing key market drivers and impediments affecting the industry to provide a deeper understanding of how Nigerian pension funds are evaluating the private equity asset class in the country. The survey respondents collectively manage pension assets amounting to ₦7.6 trillion (over US\$19.0 billion) as of December 2020, representing 83% of the total value of pension assets managed by Pension Fund Administrators in Nigeria².

The survey finds that Nigerian pension funds display a strong appetite for private equity investment both locally and across the continent: 75% of the Pension Fund Managers that participated in the survey plan to accelerate or maintain their current pace of capital commitments to African PE in the next five years. Crucially, none of the survey respondents indicated a desire to decelerate their pace of capital deployment to African private equity in either the short or medium term, which paints an optimistic, promising outlook for the asset class.

Although more than half of the Nigerian Pension Fund Managers surveyed had no preference regarding the sector focus of the private equity funds they invest in, Infrastructure, Healthcare and Agribusiness were identified by the largest proportions of Pension Fund Managers as attractive sectors for PE investment in Africa over the next three years.

In evaluating the opportunities present in Africa's PE industry, survey respondents are also cognisant of a number of potential obstacles: highlighting a perceived weak exit climate and a limited number of established African GPs as significant challenges for pension funds investing in African private equity. Respondents are, however, satisfied with the current regulatory environment and the investment guidelines issued by the National Pension Commission, given that just under half of respondents did not consider any of the current requirements related to the investment of pension fund assets as a challenge for pension funds investing in African private equity.

₦35.48 billion

(over US\$92 million) committed to private equity funds by the Nigerian pension industry

75%

75% of the Pension Fund Managers that participated in the survey plan to accelerate or maintain their current pace of capital commitments to African PE



Infrastructure, Healthcare and Agribusiness were identified by the largest proportions of Pension Fund Managers as attractive sectors for PE investment in Africa

² The total sum of pension assets managed by survey respondents excludes those of closed pension funds, whose individual assets under management were not disclosed in the National Pension Commission 2020 Annual Report.

History of the Pension Funds Industry in Nigeria

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Evolution of the Pension Industry in Nigeria

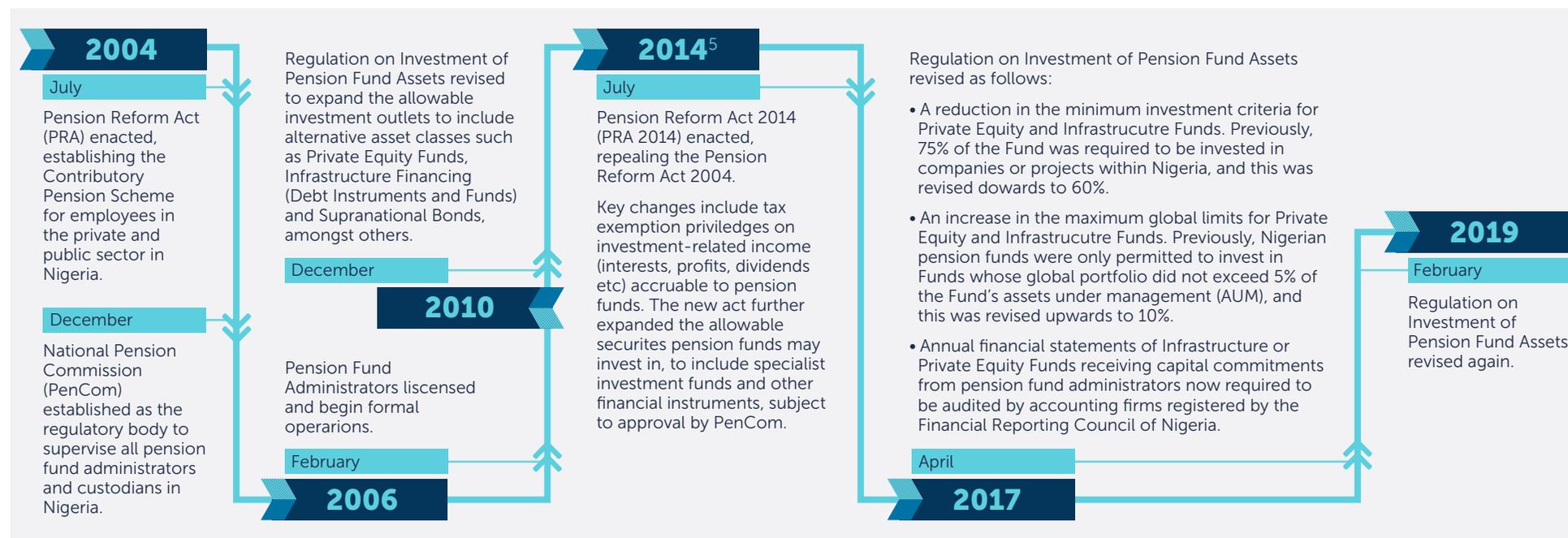
Nigerian pension funds, which cumulatively held assets amounting to ₦12.31 trillion (roughly US\$29.9 billion) across all fund types in December 2020, have a decent amount of capital at their disposal with which to invest³.

In local currency, total pension fund assets have multiplied five-fold in the last decade, from ₦2.25 trillion (US\$14.5 billion) in 2011⁴. Although only 0.29% of the value of Nigerian pension funds have been allocated to private equity, the growing value of pension assets has increased the pool of domestic capital available to indigenous fund managers in Nigeria. 56% of GPs that participated in AVCA's 2021 *Private Equity Industry Survey* believe that local capital will catalyse the PE industry in Africa. Nigerian pension funds help to fill the critical

need for local capital within the country's PE industry, and their catalytic role has grown commensurately to their asset growth.

The role of pension funds in Nigeria's PE industry has evolved alongside the changes in regulation issued by the National Pension Commission. Pension fund investment in private equity was non-existent prior to December 2010, when allowable investment outlets were expanded to include alternative asset classes such as private equity and infrastructure funds, among others. This evolution in the permitted scope of their investments has enabled more investment into PE over time.

Figure 1: Timeline of the Evolution of Nigerian Pension Fund Investment in Private Equity



³ This figure represents the net assets value of pension assets across all fund types: namely Approved Existing Schemes (AES), Closed Pension Funds (CPFA), and Retirement Savings Account (RSA) Funds.
⁴ The estimated value of pension assets was taken from the relevant Annual Reports (2011, 2020) issued by the National Pension Commission, with the US Dollar conversion of local currency values taken as at the spot rate at the time of publication of the relevant regulatory report.
⁵ This outline only covers key changes instituted by the 2014 Pension Reform Act specifically related to investment regulation of pension assets, and as such is not a comprehensive overview of the major developments made by the new legislation. For a full and detailed summary of revisions made under the new Act, please see [this resource](#).



Current Investment Guidelines for Pension Funds Operating in Nigeria

The National Pension Commission has issued the following guidelines on the regulation of pension fund investments in private equity funds in Nigeria⁶:

Exit Routes

- The PE Fund ought to have satisfactory pre-defined liquidity and exit routes.

Fund Managers

- The PE Fund Manager must be registered with Nigerian Securities & Exchange Commission (SEC).
- The key principals of the PE Fund (CEO and CIO) each ought to have at least ten years of investment experience or experience managing third party assets.

LP Base

- In the absence of globally known Foundations & Endowments, DFIs or Sovereign Wealth Funds as limited partners in the PE Fund, the Fund Manager must retain a minimum investment of 3% of the PE Fund and ought to have a minimum Investment Manager rating of 'BBB'.
- These limited partners must have been in existence for a minimum of 10 years and have a fund size of not less than US\$1 billion.

Geographical Remit

- A minimum of 60% of the PE Fund is required to be invested in companies or projects within Nigeria.

⁶ This is only a selection of current investment guidelines governing pension investment in private equity, and as such is not an exhaustive overview of the quality requirements issued by the National Pension Commission.

Growth Drivers and Challenges for Pension Fund Investment in Nigerian Private Equity





Growth Drivers for Pension Fund Investment in Nigerian Private Equity

Nigeria's strong macroeconomic fundamentals in West Africa is a growth driver for the country's PE industry. As a regional powerhouse, Nigeria is home to the continent's largest population and consumer class, and thus represents an established and relatively stable market for investment in West Africa in the long term, in spite of more recent short term macroeconomic challenges. Nigeria consistently attracts a significant proportion of the volume of private equity and venture capital funding channelled to West Africa. Between 2015 and 2020, Nigeria accounted for 58% of the total PE volume and 54% of the total value of PE funding allocated to West Africa. Nigeria also commanded 65% of the total volume of reported VC deals in West Africa within this five-year timeframe. Underpinning Nigeria's large share of the West African private equity market is their ascension in the World Bank's *2020 Ease of Doing Business Report*⁷. The Report named Nigeria (10) in their list of top-10 most improved economies globally, where Nigeria implemented six reforms and rose by 15 places to rank at 131.

In the midst of these growth drivers and macroeconomic tailwinds, the level of interest and investment in local private equity by Nigerian pension funds has grown substantially. Nigeria was selected by the third largest share of LPs (41%) that participated in AVCA's 2021 *Private Equity Industry Survey* as an attractive country for PE investment in Africa over the next three years. Although Nigeria has slipped slightly from its longstanding first place position (in AVCA's 2016-2018 surveys) it remains a rising star for both PE and VC investment in West Africa, maintaining its reputation as an attractive regional investment destination. Nigeria's growing attractiveness as an investment destination for both regional and international investors is another driver of Nigerian pension funds' investment in local PE funds. Not only does Nigeria's popularity amongst institutional investors signify the attractiveness of the asset class and its potential for high returns, it widens the pool of global limited partners willing to allocate capital to the asset class. This is significant given the requirements issued by the National Pension Commission related to the LP base of PE Funds, which mandates the presence of globally known institutional investors as existing limited partners in a private equity fund to enable prospective investment by Nigerian pension funds.

58%

Between 2015 and 2020, Nigeria accounted for 58% of the total PE volume allocated to West Africa

65%

Nigeria also commanded 65% of the total volume of reported VC deals in West Africa between 2015 and 2020

Underpinning Nigeria's large share of the West African private equity market is their ascension in the World Bank's *2020 Ease of Doing Business Report*

⁷ The World Bank, 2020. [Doing Business 2020: Comparing Business Regulation in 190 Economies](#)



Challenges Affecting the Attractiveness of the Asset Class

While there is a strong interest in investment diversification, the (relatively) high risk inherent to the private equity asset class can be a challenge for pension funds. As managers of public funds, Pension Fund Administrators (PFAs) in general have a lower threshold of palatable risk than other institutional investors. Moreover, given that investing in emerging markets is associated with higher degrees of macroeconomic uncertainty relative to more developed, established markets, considerations of risk management are more acute for Nigerian pension funds looking to invest in private equity. In this environment, the safety-first approach embedded in most pension funds' investment philosophies makes them more likely to invest in government bonds or treasury bills over conventional private equity, where the ratio of risk to return can be more unpredictable.

Regulatory bias in the allocation of pension fund assets is another challenge reducing the attractiveness of the private equity asset class for Nigerian PFAs. Although the regulatory framework makes provisions for the investment of pension funds in private equity, such investments are capped at a maximum of 5% of the pension funds' total assets (see Figure 2). When compared to other asset classes, this maximum permissible allocation is a bottleneck for the generation of local capital in Nigeria's PE industry. For example, Retirement Savings Account (RSA) Funds in Nigeria may invest between 60-80% of their total assets in government securities, and between 30-60% in money market instruments. The subpar allocation of pension fund assets to private equity funds in Nigeria may therefore be attributed to these regulatory limitations restricting the proportions of capital that may be deployed towards the asset class.

Figure 2: Pension Assets Under Management Available to Private Equity in African Markets⁸

	Country	Regulatory Authority	Total Pension Assets Under Management (Local Currency, bn)	Total Pension Assets Under Management (US\$, bn)	Year	Maximum Allocation to PE	Available for PE (US\$, bn)
East Africa	Kenya	Retirement Benefits Authority	KES 1, 300	12.9	2019	10%	1.29
	Uganda	Uganda Retirement Benefits Regulatory Authority	UGX 16, 900	4.6	2021	15%	0.692
Southern Africa	Botswana	Non-Bank Financial Institutions Regulatory Authority	BWP 93.1	8.6	2019	5%	0.429
	South Africa	Financial Sector Conduct Authority	ZAR 4, 262	346	2017	10%	34.6
West Africa	Ghana	National Pensions Regulatory Authority	GHS 33.4	5.8	2020	10%	0.58
	Nigeria	National Pension Commission	NGN 12, 310	29.9	2021	5%	1.49
North Africa ⁹	Egypt	Egyptian Financial Supervisory Authority	EGP 44.3	6.8	2014	Unclear	Unclear
	Morocco	The Supervisory Authority For Insurance & Social Welfare	MAD 269.3	30.0	2014	Unclear	Unclear

⁸ The estimated value of pension scheme assets (excluding those presented for North Africa) were taken from the most recent regulatory reports available for each country, with the US Dollar conversion of local currency values taken as at the spot rate at the time of publication of the relevant regulatory report.

⁹ The estimated value of pension scheme assets for North Africa were taken from the 2020 edition of PricewaterhouseCoopers (PWC) [Africa Asset Management](#) study.



This 5% permissible allocation as a restriction to capital deployment in Nigeria’s private equity industry is even more acute when compared to investment limits in other emerging and developed markets (see Figure 3). In both the United States and the United Kingdom, there are no regulatory limits on the proportion of pension assets that may be allocated to private equity,

although pension fund managers are limited by fiduciary diversification rules. The upper limits in Brazil, China, India and South Africa (all members of the BRICS group of leading emerging market economies) are set at 10%: double the maximum allocation to private equity permitted by the National Pension Commission.

Figure 3: Pension Assets Under Management Available to Private Equity in Emerging and Developed Markets

Region	Country	Regulatory Authority	Total Pension Assets Under Management (US\$, bn) ¹⁰	Year	Maximum Allocation to PE	Available for PE (US\$, bn)
Emerging Asia	India	Ministry of Human Resources and Social Security	184	2020e	10%	18.4
	China	Ministry of Human Resources and Social Security	285	2020e	10% ¹¹	-
Latin America	Brazil	National Superintendence of Complementary Pensions	195	2020e	10%	19.5
	Mexico	National Commission for the Retirement Savings System	259	2020e	20% (total permissible exposure to private investment funds)	51.8
Developed Markets	United Kingdom	The Pensions Regulator	3,564	2020e	No prescribed upper limit	-
	United States	Employee Benefits Security Administration of the Department of Labor	32,567	2020e	No prescribed upper limit (limited by fiduciary diversification rules)	-

¹⁰ The estimated value of pension scheme assets were taken from the 2021 edition of the [Global Pension Assets Study](#) produced by Thinking Ahead Institute.

¹¹ The National Social Security Fund received permission to invest in venture capital and private equity funds in 2008, and is the only pension fund in the country with formal regulatory approval to do so. Investment regulation for other domestic pension funds remains conservative, with high-risk assets classes such as hedge funds, infrastructure funds, private equity and foreign markets barred from pension investment.



While the current regulatory framework enables the investment of pension funds in private equity, a prerequisite for such investments is that a minimum of 60% of the chosen PE Fund must be invested in companies or projects within Nigeria. Although these requirements related to the geographical remit of PE funds have changed over time (the April 2017 amendment to PenCom's Regulation on Investment of Pension Fund Assets reduced the minimum investment criteria from 75% to 60%) they nevertheless limit the ability of Nigerian PFAs to allocate capital to PE Funds outside the country. Nigerian pension funds are thus unlikely to invest in PE funds with a pan-African or sub-Saharan African geographic focus. Investments in funds with an explicitly regional (West Africa) focus are more likely, again provided the lion's share of the fund's portfolio is localised in Nigeria. However, some pan-African fund

managers are overcoming this challenge by establishing parallel local funds that can attract pension capital to bypass this 60% geographical requirement.

Another constraint to investing in African funds lies in the fact that Nigerian pension funds are only permitted to invest in PE Funds where the Fund's global portfolio does not exceed 10% of the Fund's assets under management (AUM). This requirement has also changed over time (previously, the PE Fund's global portfolio could not exceed 5% of the Fund's AUM) but despite this upward revision, it once again constrains the range and scope of PE funds that PFAs may invest in. Nigerian Pension Funds would have been precluded from investing in funds from larger PE houses (specifically those with a global geographic remit) whose African PE portfolios nevertheless included extensive investments in Nigeria.



Changes Necessary to Catalyse More Pension Capital Allocation to Private Equity

There have been a number of regulatory and legal changes introduced in Nigeria that have significantly streamlined the private investment market in recent years. The Companies and Allied Matters Act, passed in August 2020, has simplified the legal processes surrounding the setup of PE and VC funds.

This new legislation is part of a broader initiative by the Nigerian government to improve the country's business environment, and now enables private equity and venture capital firms in Nigeria to be established as limited liability partnerships¹². Previously, given the challenges and uncertainties associated with structuring private equity funds and deals in Nigeria's regulatory framework, Nigerian fund managers typically established their funds outside the country. The Companies and Allied Matters Act thus increases the likelihood of indigenous fund managers seeking fund domiciliation in Nigeria, increasing the scope of available private equity funds PFAs can invest in.

Nevertheless, rules regarding investment of pension funds in private equity need to be revisited in order to promote more pension fund investment in the asset class. The National Pension Commission mandates that PFAs may only invest in PE funds where the fund manager is registered with the Nigerian Securities & Exchange Commission (SEC). However, in practice most Nigerian private equity funds only pursue SEC registration when there is an intention to source investment funds from Nigerian pension funds. Legal advisors Banwo & Ighodalo maintain that "the value of restricting such investments to funds registered with the SEC is unclear given the limited monitoring of such fund managers"¹³. Therefore, while there may be several Nigeria-focused PE & VC funds active and compliant with most (if not all) of the other requirements stipulated by the National Pension Commission, Nigerian PFAs would nonetheless be precluded from investing in the same if they are not registered with the SEC.

¹² AVCA, 2020. [Afri-Spective Blog: CAMA 2020 and the Implications for the Private Equity Industry](#).

¹³ Banwo & Ighodalo, 2015. [The Evolving Nigerian Private Equity Landscape: Finally Coming of Age?](#)

Nigerian Pension Funds' Investment in Private Equity

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Profile of Nigerian Pension Funds

Close to **two-thirds** (63%) of Pension Fund Managers that participated in the survey currently manage less than **US\$999 million** of pension assets.

The profile of respondents reflects the significant growth in the size of pension assets in recent years. Just under half (44%) of Pension Fund Managers that participated in the survey currently manage pension assets valued between US\$500 million and US\$999 million, while another 31% manage between US\$1 billion and US\$4.9 billion of pension assets.

Despite expansions to the regulation of pension fund assets and the growing capital base at their disposal, pension investment in alternatives remains fairly muted. Very few of the Pension Fund Managers that participated in the survey (only 6%) have an exposure to alternatives amounting to 10% or more of their portfolio value across any alternative asset class. 88% of survey respondents have an exposure to Private Equity Funds and Infrastructure Funds, while 75% have an exposure to Real Estate Funds. The vast majority of survey respondents (94%) do not currently have an exposure to Venture Capital Funds, further emphasising this conservative approach.

Figure 4: Total Assets Under Management (Across All Asset Types)

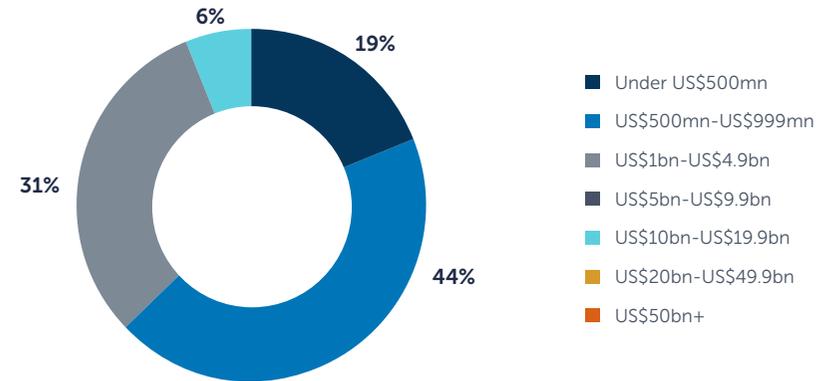
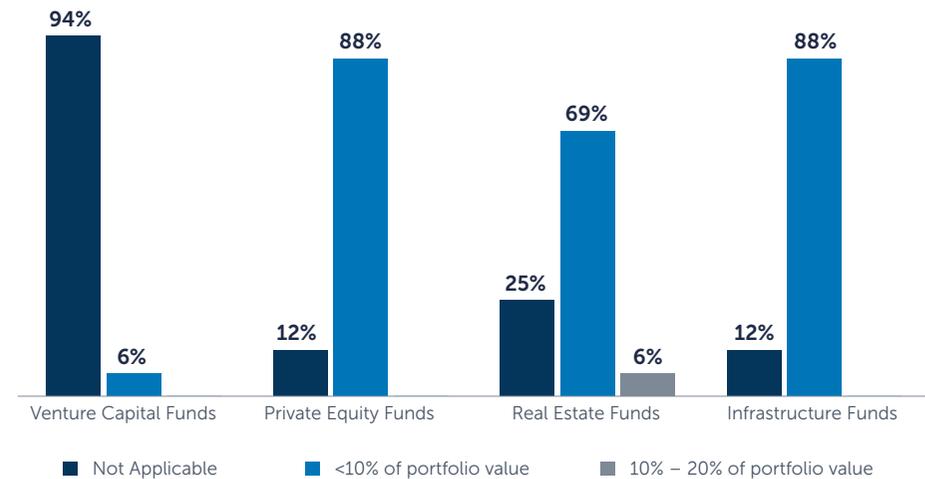


Figure 5: Exposure to Alternative Asset Classes (VC, PE, Real Estate, Infrastructure)





81% of Pension Fund Managers that participated in the survey have capital commitments to private equity in Nigeria, reducing to 33% when expanded regionally to private equity in West Africa.

Four in five of survey respondents currently have capital commitments to private equity in Nigeria. When expanded regionally and continentally, the proportion of respondents with current capital commitments in private equity reduces significantly. Only a third (33%) have capital commitments to private equity in West Africa, dropping to 27% with commitments to private equity in sub-Saharan Africa.

Turning to the value of these commitments, slightly over two thirds (69%) of respondents have committed between US\$1 million and US\$20 million to Nigerian private equity. Larger ticket sizes (US\$21 million and above) are concentrated in national and regional markets only.

Figure 7: Year Organisation First Started Investing in African PE

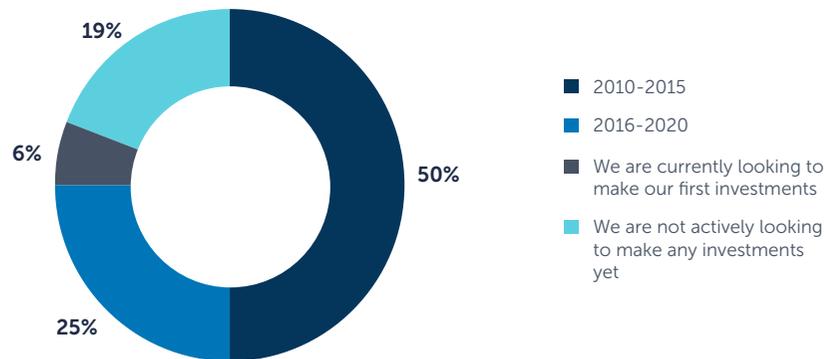


Figure 6: Current Commitments to PE (National, Regional and Continental Markets)

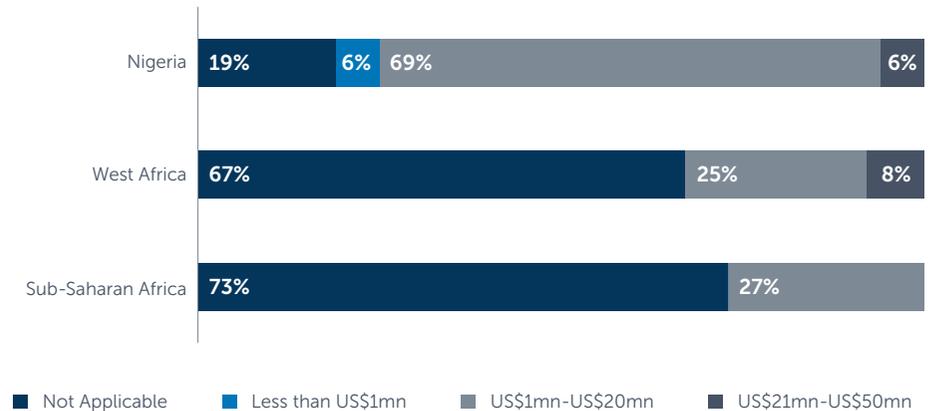
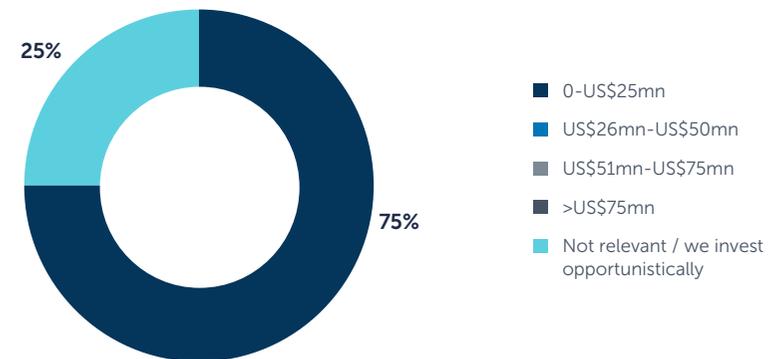


Figure 8: Average PE Fund Commitment Size





Historic & Planned Investments into African PE

None of the Pension Fund Managers that participated in the survey are currently invested in any Afro-centric VC Funds, while **81%** are currently invested in Afro-centric PE Funds.

Although pension funds have been permitted to invest in private equity and venture capital since December 2010, none of the survey respondents are either currently invested or have previously invested in any Afro-centric (i.e. Africa focused) VC Funds, which remains a relatively under-explored asset class. Conversely, a significant majority of respondents (81%) are currently invested in private equity vehicles domiciled in both Nigeria and elsewhere on the continent.

Turning to historic investments in the asset class, three quarters (75%) of survey respondents have invested in between one and three PE funds in recent history. Only 6% have invested in more than four PE funds thus far. Examples of PE funds that have received capital allocations from Nigerian pension funds include the *Capital Alliance Private Equity Funds* managed by African Capital Alliance, as well as the *Actis Africa Real Estate Funds* managed by Actis.

Close to a fifth of respondents (19%) have yet to invest in an Afro-centric PE fund. However, of this cohort, 67% are looking to accelerate their pace of capital deployment in African PE funds in the next three to five years. Respondents that have yet to make any private equity investments have a combined assets under management of ₦1.1 trillion (equivalent to US\$2.97 billion), as of December 2019.

Figure 9a: Current Investments in African PE or VC Funds

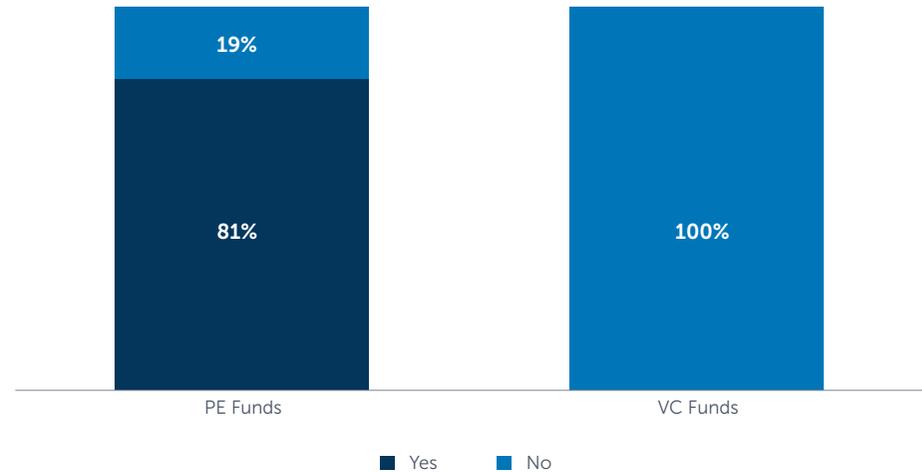
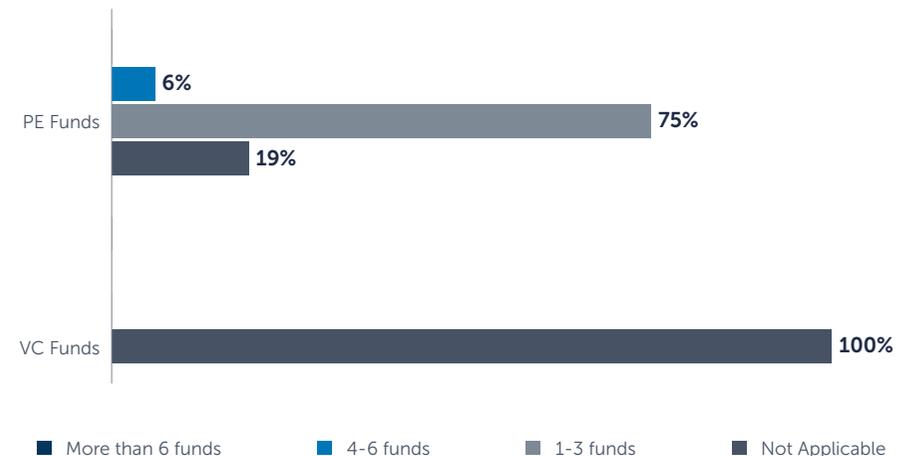


Figure 9b: Historic Investments in African PE or VC funds



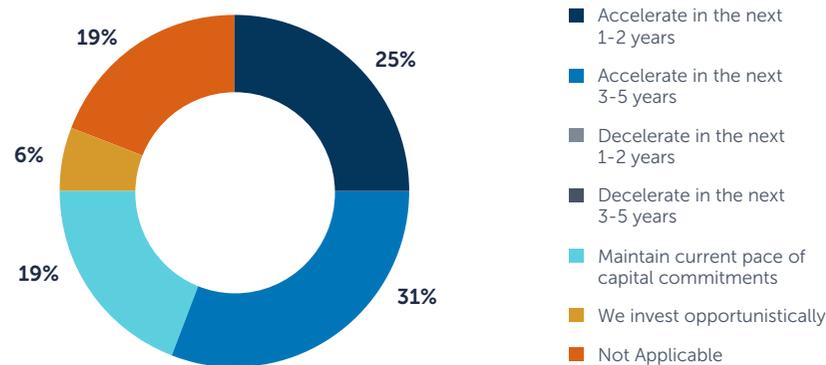


75% of Pension Fund Managers plan to increase or maintain their current pace of capital commitments to African PE.

A quarter of the Pension Fund Managers that participated in the survey plan to increase their African PE allocation over the next three years, with this figure climbing to 56% when extended to a five-year horizon. Of the pension funds planning to increase their allocation to African PE, 78% are currently invested in Nigerian PE Funds, with another 33% invested in PE Funds with a regional (i.e., West African) geographical remit.

None of the survey respondents indicated a desire to decelerate their pace of capital deployment to African private equity in either the short or medium term, which paints an optimistic, promising outlook for the asset class.

Figure 10: Plans Regarding the Pace of Capital Deployment in African PE

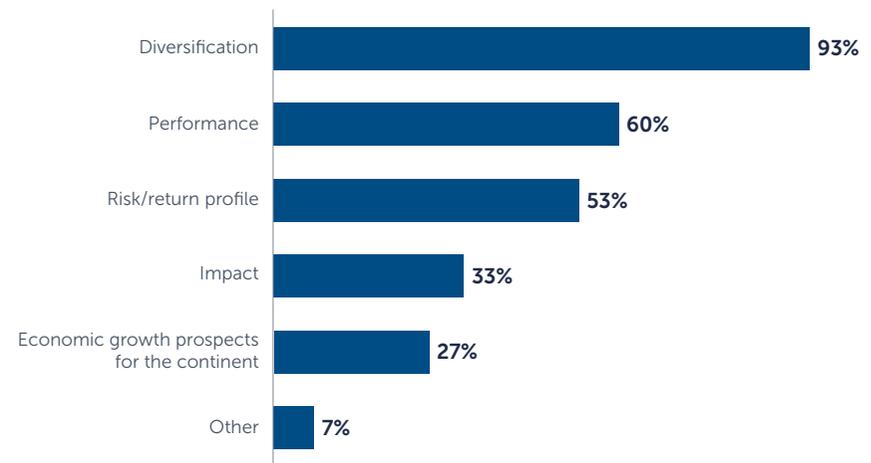


Pension Fund Managers identified **Diversification** (93%) and **Performance** (60%) as the main push-factors driving their plans to increase or maintain their African PE allocation in the next three years.

A vast majority (93%) of Pension Fund Managers that plan to increase or maintain their exposure to African PE in the next few years are motivated to do so by a desire for portfolio Diversification. Another 60% cite Performance as an important factor driving their investment plans. Of these, more than half consider the attractiveness of African PE to be unchanged following the Covid-19 pandemic, and another 78% expect returns of over 2.1x from their African PE portfolio in the next five years.

At 53%, the third most popular driving factor identified by participants was the Risk/Return Profile of the private equity asset class. Crucially, this indicates that pension managers are either more comfortable managing the Risk/Return of private equity vis a vis their portfolio, or that the longstanding perception of elevated risk associated with the asset class is gradually declining.

Figure 11: Drivers for Increasing or Maintaining African PE allocation Over the Next Three Years



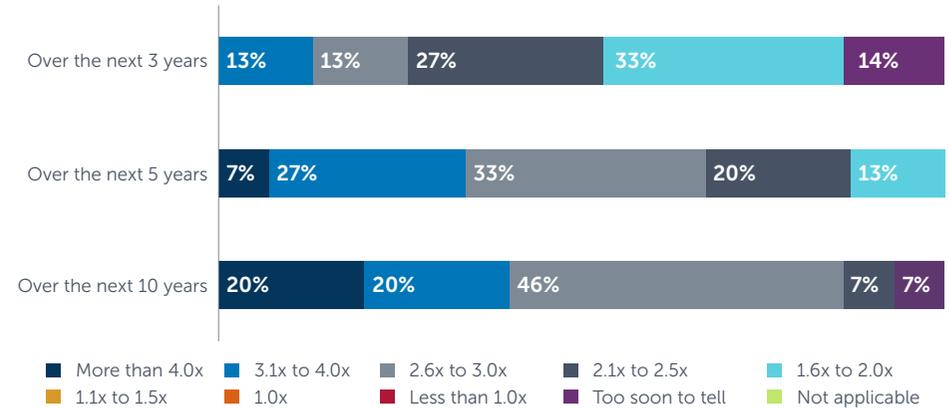


40% of Pension Fund Managers expect African PE returns to **exceed 3.0x** over the next ten years.

In the next three years, 53% of Pension Fund Managers expect African PE returns of 2.1x to 4.0x. The respondents that expect these high returns in the next three years also view Infrastructure (88%), Healthcare (66%), Agribusiness and Utilities (50% each) as attractive sectors for PE investment in Africa over the same period. The respondents that considered it “too soon to tell” or make aggregate cash-on-cash returns predictions about their African PE portfolio in the next three years (14%) all began investing in African PE in between 2010 and 2015. Over a third of this cohort also considered an unattractive risk to return profile and a perceived weak exit climate (38% each) as the biggest challenges for pension funds investing in African private equity, which likely contributes to this hesitancy to make short-term predictions of expected returns for their PE portfolio.

Long-term predictions are more optimistic. When extended over a five-year time horizon, the proportion of respondents expecting PE returns of over 2.0x rises to 87%. This figure climbs even higher to 93% when extended over a ten-year time horizon, suggesting a strong long-term outlook for returns within the industry.

Figure 12: Expectations about the aggregate cash-on-cash returns from African PE





Preferences & Expectations

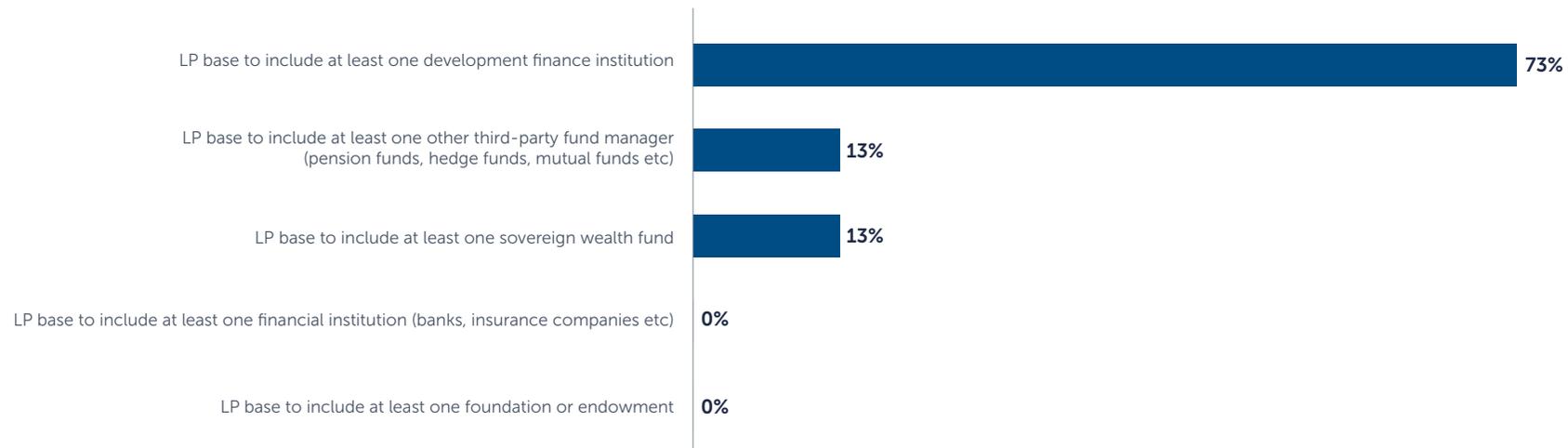
Investor Preferences

73% of Pension Fund Managers that participated in the survey prefer the presence of at least **one development finance institution (DFI)** in the LP base of private equity funds they invest in.

The emphasis placed on the presence of a DFI likely corresponds to the requirement issued by the National Pension Commission, which mandates that private equity funds soliciting capital allocations from Nigerian pension funds have globally known Foundations & Endowments, DFIs or Sovereign Wealth Funds as limited partners in the PE Fund.

Of note, neither Financial Institutions (such as banks, insurance companies etc.) nor Foundations were selected by survey respondents. This suggests that neither commercial nor philanthropic limited partners are in themselves a sufficient motivator for pension funds to invest in a private equity fund. Instead, an equal proportion of participating Pension Fund Managers expressed a slight preference for the LP base of the private equity funds they invest in to include at least one other third-party fund manager (13%) and at least one Sovereign Wealth Fund (13%). As custodians of public finances, this preference for other third-party fund managers in the LP base of a private equity fund likely stems from risk-management concerns. The presence of other third-party fund managers in the LP base of a given private equity fund is an implicit indicator that the fund in question has passed the internal risk assessment or due diligence processes of other institutional investors managing external funds, which likely share similar risk to return thresholds as the pension funds themselves.

Figure 13: Preferences regarding LP base when investing in a PE Fund



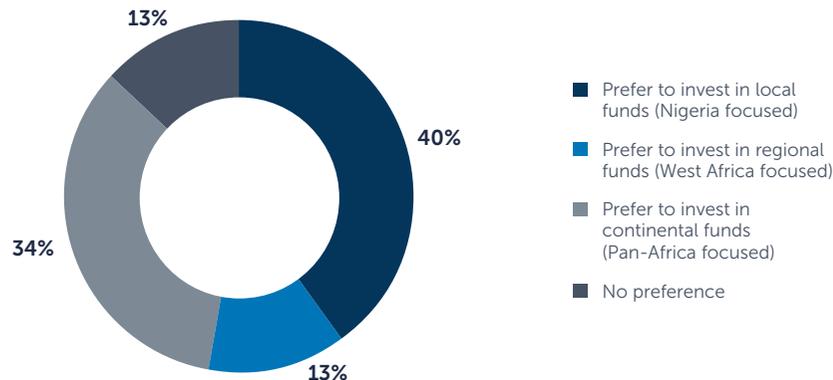


Two in five of the Pension Fund Managers that participated in the survey prefer to invest in **local** (i.e. Nigeria-focused) private equity funds.

40% of survey respondents prefer to invest in local funds. Of these, 50% first started investing in African private equity between 2016 and 2020, while another third (33%) first started investing between 2010 and 2015. The relatively recent exposure to the asset class may be a contributor for this preference to invest in familiar, Nigeria-focused private equity funds.

Curiously, survey respondents expressed a stronger investment preference for continental private equity funds (i.e. pan-Africa focused funds) over regional (i.e. West Africa focused) funds. A third (34%) prefer to invest in continental private equity funds, compared to just 13% which showcased a preference for regional funds. Close to two thirds (60%) of the Pension Fund Managers that indicated a preference for continental private equity funds currently have capital commitments between US\$1mn and US\$20mn to private equity in sub-Saharan African markets. Of note, 80% of this cohort plan to accelerate or maintain their African PE allocation in the next few years, citing Diversification as the driver for these plans.

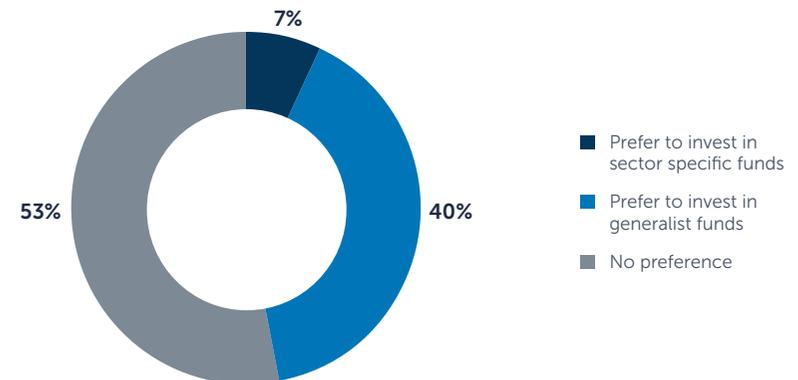
Figure 14: Preferences regarding the geographic remit of PE Fund investments



More than half of Nigerian Pension Fund Managers have **no preference** regarding the sector focus of the private equity funds they invest in.

A slight majority (53%) of participating Pension Fund Managers have no preference regarding the sector focus of the private equity funds they invest in. Of the minority (7%) that prefer to invest in sector-specific funds, Healthcare, Infrastructure and Real Estate were identified as the most attractive sectors for private equity investment in the next three years.

Figure 15: Preferences regarding the sector focus of PE Fund investments





Investor Expectations

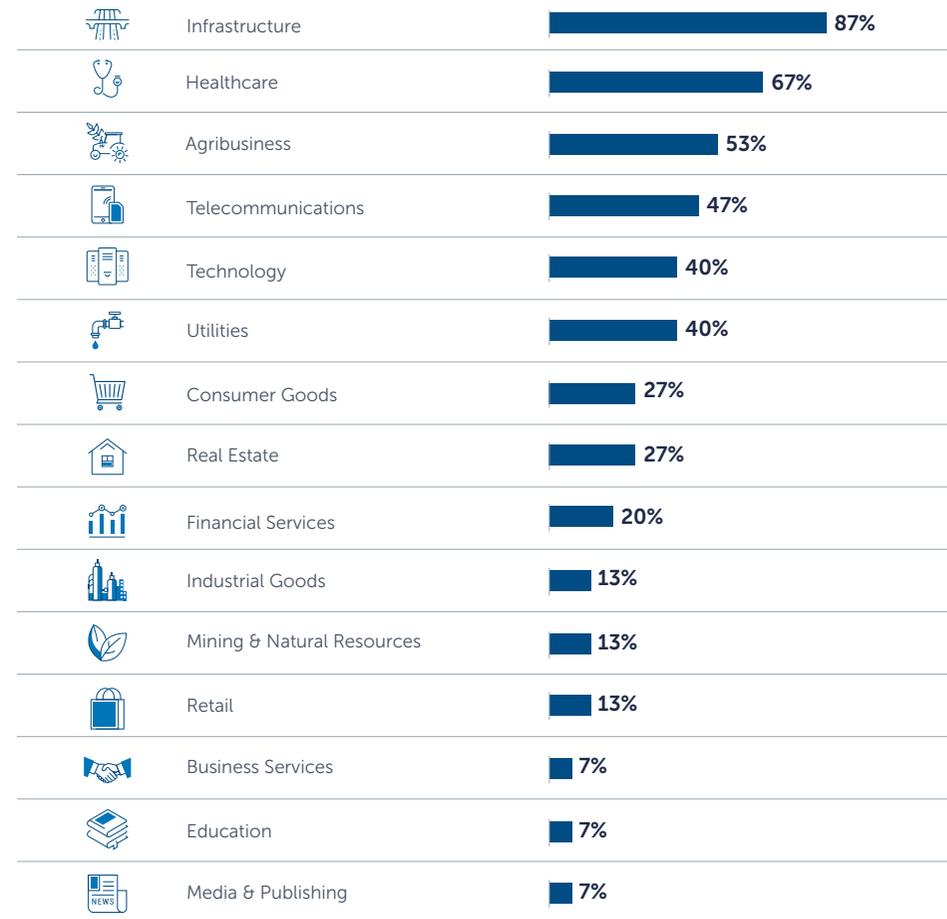
Infrastructure, Healthcare and Agribusiness were identified by the largest proportions of Pension Fund Managers as attractive sectors for PE investment in Africa over the next three years.

Infrastructure was selected by the largest proportion of Pension Fund Managers (87%) as an attractive sector for PE investment in Africa over the next three years, with Healthcare following in close second at 67%. A large majority (85%) of respondents that view Infrastructure as an attractive sector for future investment have current investments in infrastructure funds, although these investments only equate to less than 10% of the pension funds' portfolio value.

Utilities, a prominent and growing sector of interest in West Africa (attracting 9% of PE deals by volume in the region between 2015-2020) was chosen by 40% of respondents as an attractive sector for PE investment in the short-term future. Another 40% of survey respondents also identified Technology, which has developed into one of the highest-interest emerging sectors for private investment in Africa, as an attractive sector for future private equity investment.

Sectors associated with the rise of the African consumer, such as Consumer Goods (27%), Retail (13%) and Education (7%) showed only modest interest from Pension Fund Managers surveyed. This is unusual considering the prevalence of the consumer theme in Nigeria and West Africa more generally, which commanded 26% of PE deal volume in the region between 2015 and 2020¹⁴.

Figure 16: Most attractive sectors for PE investment in Africa over the next three years



14 More specifically, deals within the Consumer Discretionary and Consumer Staples sectors each accounted for 13% of the total volume of PE deals in West Africa, 2015-2020.

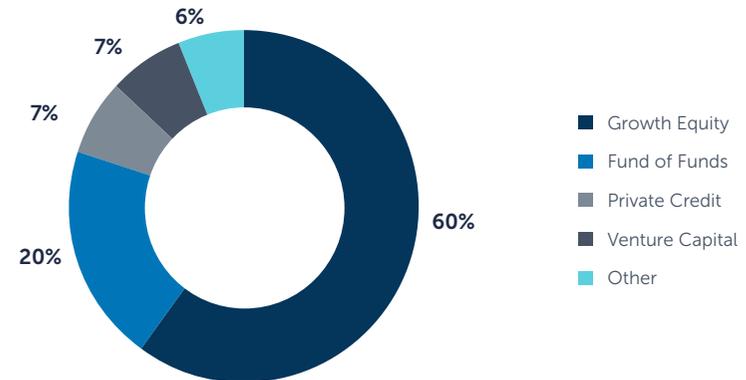


60% of Pension Fund Managers consider **growth capital** as a strategy of interest when investing in African PE over the next three years.

Close to two thirds of Pension Fund Managers (60%) view growth capital as a strategy of interest when investing in African PE over the next three years. Fund-of-Funds was the second most popular preferred strategy, selected by a fifth of respondents.

Of note, Venture Capital was only selected by 7% of the Pension Fund Managers that participated in the survey as a preferred investment strategy. This contrasts the results from AVCA's 2021 *Private Equity Industry Survey*. 40% of the global pension funds that participated in the *Industry Survey* favoured Venture Capital as an investment strategy, with West Africa chosen by 71% of these as an attractive region for private equity investment in the next three years. The implies a slight disconnect between the preferences exhibited by domestic pension funds and those exhibited by international (i.e. non-Nigerian) pension funds. Venture Capital is emerging as a growing investment strategy of interest for the latter, but remains uncharted territory for the former.

Figure 17: Pension Fund Managers' preferred strategies when investing in African PE





60% of Pension Fund Managers that participated in the survey take an **opportunistic approach** to investing in first-time GPs raising Afro-centric funds, and 40% have invested in an African GPs first fund in the last 5 years.

60% of survey respondents take an opportunistic approach to investing in first-time GPs raising Afro-centric funds, where their likelihood of investment is determined on an individual fund-by-fund basis. 13% of survey respondents would likely invest in an African GP's maiden fund, while the number of respondents that are unlikely to invest in first-time GPs in Africa stands at 27%.

Although 40% of survey respondents have invested in a first-time African GP in the last 5 years, only a small proportion of these (17%) would likely do so again. That said, Pension Funds that have historically supported more first-time African GPs were targets of more fund commitment requests in 2020. 65% of Pension Fund Managers that have invested in a first-time fund manager in the last 5 years were approached by 6-10 African GPs for fund commitments in 2020. Conversely, two thirds of Pension Fund Managers that have not made recent investments in a first-time GP were approached by fewer than 5 GPs in 2020, and another third (33%) were not approached by any fund managers at all.

Figure 18a: Preferences regarding investing in a first-time GP in Africa

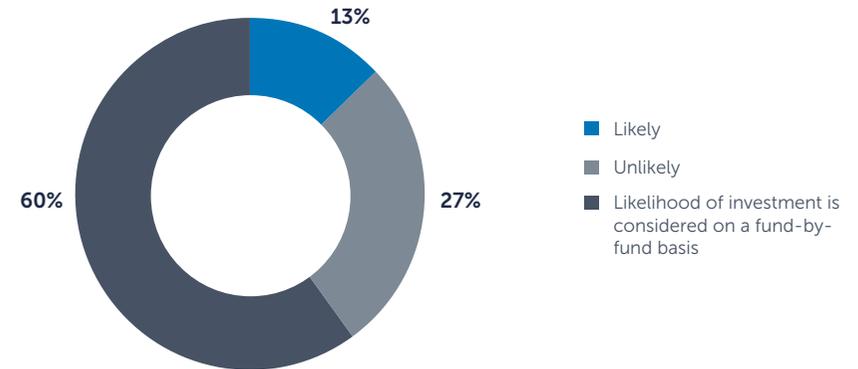
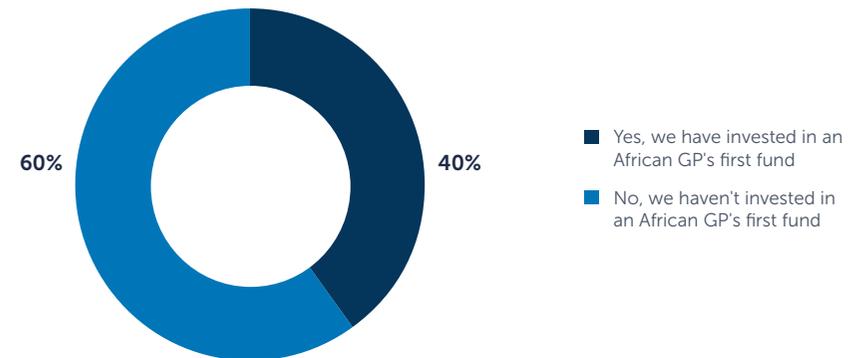


Figure 18b: Historic investments in first-time GPs in Africa (last five years)





79% of Nigerian Pension Fund Managers prefer to invest in fund managers that have raised between **one and three funds**, while slightly under half (47%) have no preference on the size of the PE fund managers they allocate capital to.

Over 90% of the Pension Fund Managers that took part in the survey have clear preferences regarding fund manager experience when making prospective capital allocations to a PE Fund. 79% prefer to invest in fund managers that have raised between one and three PE funds, while 14% prefer to invest in fund managers that have successfully raised four funds or more. The minority that did not express a preference regarding fund manager experience equally did not express a preference for the geographic remit or sector focus of the PE funds they invest in.

Preferences related to fund manager size were more varied: a fifth preferred to invest in fund managers with US\$101mn-US\$250mn in assets under management, and an equal proportion (13% each) exhibited an investment preference for fund managers with assets between US\$251mn-US\$500m and over US\$1bn, respectively. All of the Pension Fund Managers that prefer to invest in African GPs with over half a billion in assets under management themselves also currently manage an equal value or more in pension assets.

Figure 19a: Preferences Regarding Fund Manager Experience

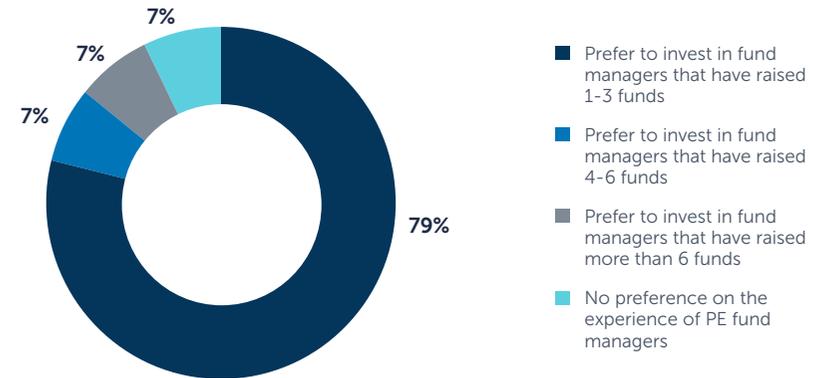
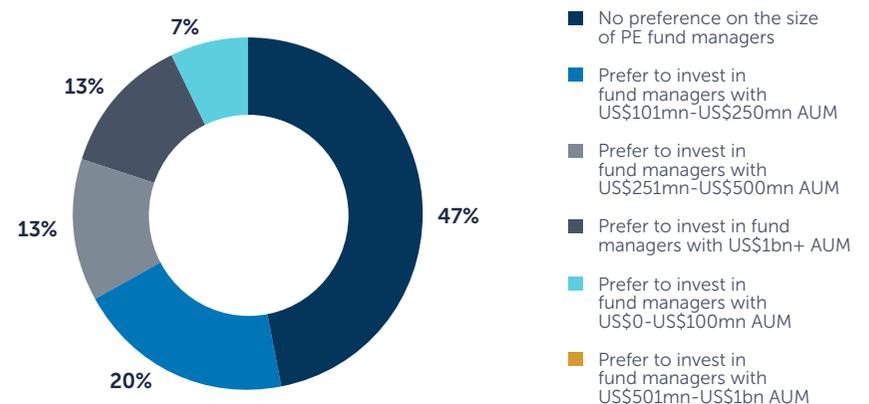


Figure 19b: Preferences Regarding Fund Manager Size





Track record of investment through to exit is considered by the largest share of Pension Fund Managers as an important factor when evaluating African GPs.

Track record (87%) was the most important evaluative criterion amongst those that participated in the survey. Over a third (38%) of respondents that selected track record as an important evaluative factor view a limited number of established African GPs as a key challenge for pension funds investing in private equity. Despite this concern, just under half (46%) of respondents that selected track record as an important factor have also invested in an African GP's first fund in the last five years.

Participation by a DFI (67%) was another important factor highlighted by the surveyed pension funds. However, at 7%, the range and size of other LP commitments to a given PE Fund soliciting capital commitments were the least selected evaluation criteria. All the Pension Fund Managers that valued the presence of other anchor investors also plan to accelerate their pace of capital deployment in African PE funds in the next one or two years, citing Performance, Impact, Diversification and Risk/Return as the drivers for their investment plans.

The length and strength of previous working relationships among senior GP team members (47%) and the quality of GP networks (40%) also featured strongly as important factors for pension fund managers evaluating African PE fund managers.

Figure 20: Important factors in PFAs evaluation of African PE fund managers





ESG & Responsible Investing

93% of Pension Fund Managers that participated in the survey view **Environmental** factors as important or very important when investing in African PE.

An overwhelming majority (93%) of respondents categorised governance considerations (such as competitive behaviour, responsible employment, indirect economic impact, procurement practices etc) as very important when investing in African PE. In contrast, while still of import, Environmental considerations (highlighted as very important by 60%) were comparatively of slightly less concern to Pension Fund Managers. Societal considerations (such as labour practices, human rights, diversity, corruption etc) were only considered very important by 47%.

Although there is a general recognition of the importance of ESG considerations when investing in African PE, only a third of participating Pension Fund Managers have a Responsible Investment or ESG Policy in place. On a positive note, however, another third are in the process of developing one. In relation to the influence of ESG considerations on fund selection processes, 50% of respondents that either have a responsible investment policy in place or are in the process of instituting one maintains that ESG considerations feature prominently in their investment mandate.

Figure 21a: Importance of ESG considerations when investing in African PE

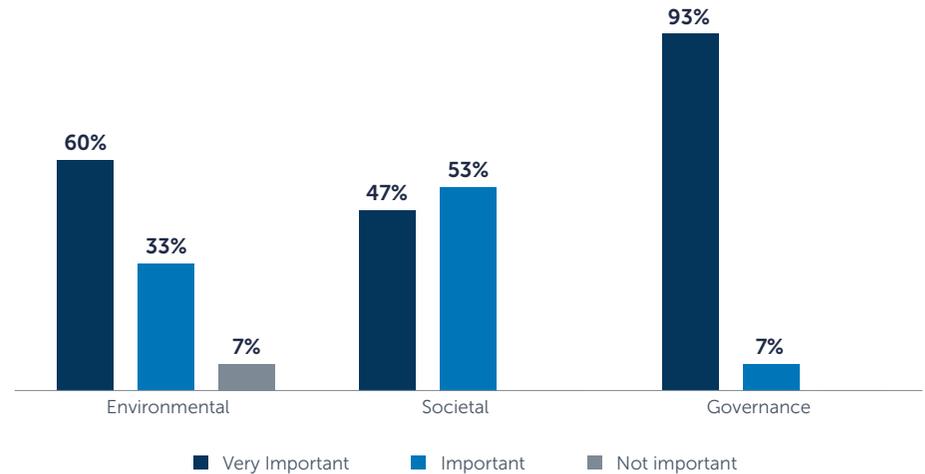
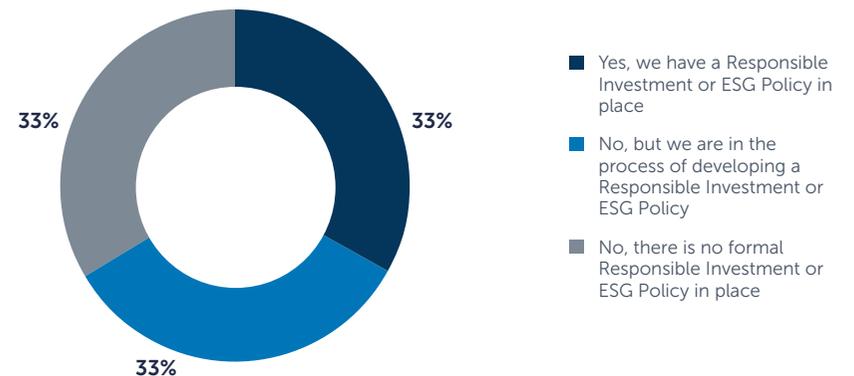


Figure 21b: Organisational Implementation of a Responsible Investment or ESG Policy





Obstacles to PE Investment

A perceived **weak exit climate** and a limited number of established African GPs are viewed as significant challenges for pension funds investing in African private equity.

60% of Pension Fund Managers that participated in the survey consider a perceived weak exit climate and unpredictable exit windows as barriers to pension funds investing in African private equity, echoing similar concerns expressed by Limited Partners in AVCA's 2021 *Private Equity Industry Survey*.

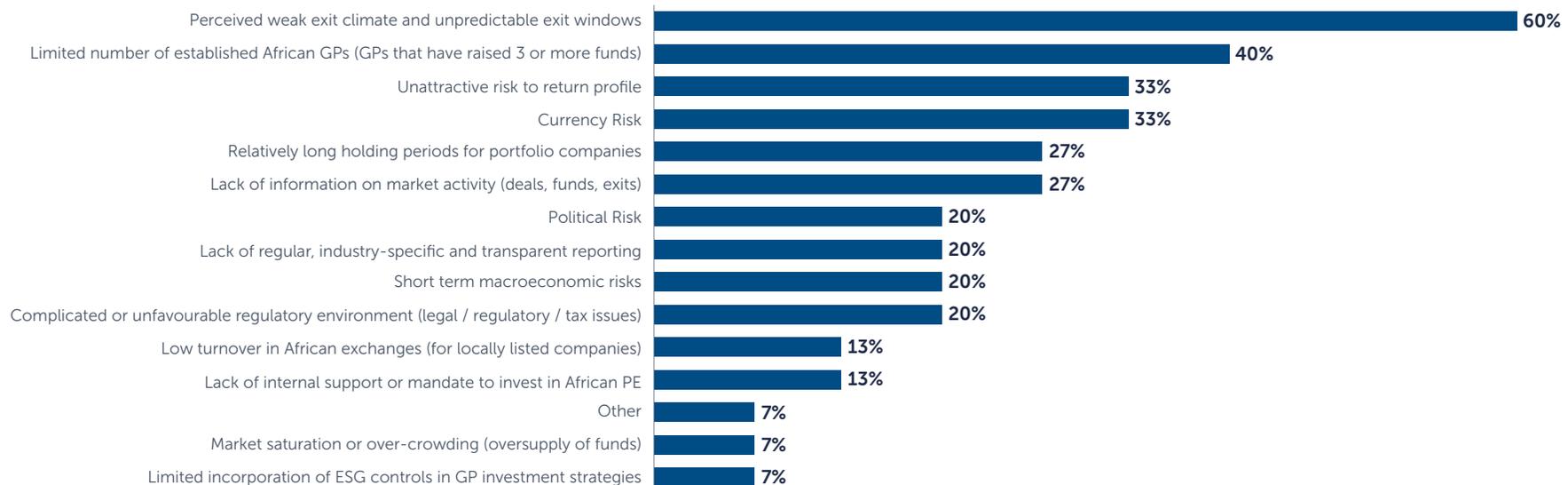
A limited number of established African GPs (40%) was also identified by Pension Fund Managers as a key challenge when investing in African PE. 83% of respondents that expressed this view prefer to invest in fund managers that have raised between one and three funds in the past, and also consider track record of investment through to exit as an important criterion when evaluating fund managers. Nevertheless, none of the respondents that highlighted a paucity of established African GPs as a constraint to PE investment considered the 10-year experience requirement for key Principals of PE fund vehicles (a quality requirement mandated by the National Pension Commission) as a

prohibitor for increased pension investment in private equity. This suggests that existing private equity fund managers, at least within the Nigerian ecosystem, have sufficient experience to meet this minimum threshold issued by the Commission, from the perspective of the pension fund managers surveyed.

27% of survey respondents maintain that a lack of information on market activity is a barrier to pension funds investing in African private equity, and another fifth (20%) point to a lack of regular, industry-specific and transparent reporting as another challenge. A response made under the "Other" category reinforces this concern, highlighting a "lack of general understanding of the PE business by investment decision makers" as a barrier to increased engagement with the private equity industry. AVCA's partnership with the Pension Fund Operators Association of Nigeria (PenOp) attempts to fill this apparent knowledge gap. Firstly, by curating research that equips pension funds with relevant, timely information enabling them to assess if and how private capital fits within their overall investment strategies, and secondly by facilitating training and collaboration opportunities for key stakeholders within the Nigerian PE ecosystem.

Finally, Currency (33%), Political (20%) and short-term macroeconomic (20%) risks were other challenges identified for pension funds investing in African PE.

Figure 22: Biggest Challenges for Nigerian PFAs investing in African PE





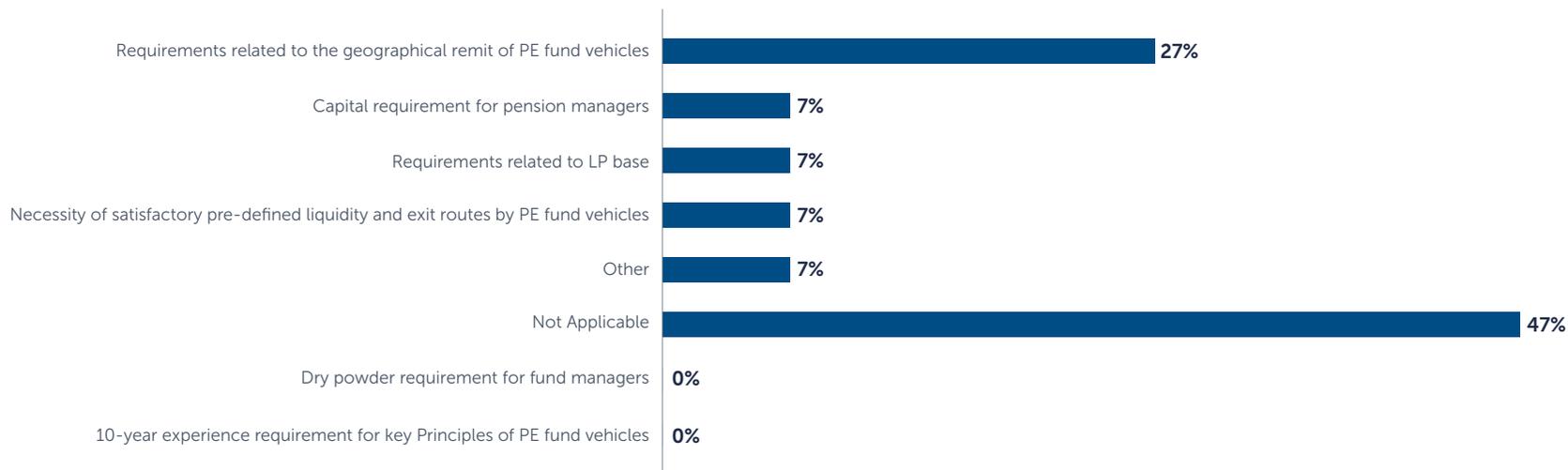
27% of Pension Fund Managers that participated in the survey view current requirements related to the geographical remit of PE fund vehicles as a possible complication for increased pension investment in Nigerian private equity.

One regulation requirement on the investment of pension fund assets in private equity is related to the geographical remit of PE fund vehicles, which are required to invest a minimum of 60% of the fund in companies or projects within Nigeria to be eligible for a capital allocation from pension funds. 27% survey respondents view this stipulation as an inhibitor to increased pension investment in African private equity. 50% of the PFAs that hold this view currently have capital commitments in private equity funds outside Nigeria (in either regional funds or sub-Saharan African funds).

The National Pension Commission raised the minimum regulatory capital for pension fund managers in Nigeria from ₦1 billion to ₦5 billion (equivalent of US\$13.14 million) in April 2021. This new capital requirement for pension managers was only chosen by 7% of respondents as a possible inhibitor of increased pension investment in Nigerian private equity. This muted concern is likely reflective of the significant increase of pension assets in Nigeria in recent years, where assets under management has grown close to fivefold in the last decade.

Close to half (47%) of respondents do not consider any of the current requirements related to the investment of pension fund assets as a complication to or inhibitor of investment in private equity. This suggests that the current regulatory environment and the investment guidelines issued by the National Pension Commission are conducive for investment in alternative asset classes, at least from a capital allocator perspective. 71% of respondents under this “Not Applicable” category are already invested in the asset class, and another 43% plan to accelerate their pace of capital deployment to African PE within the next five years.

Figure 23: Influence of Regulation Related to the Investment of Pension Fund Assets on PE Investment



Interviews with Nigerian Private Equity Firms and Pension Funds

Pension Funds and
Private Equity in
Nigeria





The Fund Manager Perspective:

Interviews with a selection of Nigerian Private Equity Fund Managers

What proportion of capital commitments in the pe funds you've raised thus far are from pension funds, and what proportion are from local and international sources?

African Capital Alliance

ACA has a long history of partnering with pension funds in Nigeria, with three Nigerian closed pension funds investing in the first CAPE fund in 1999. Since 1999 to date, we have raised a significant portion of total capital commitments across all our private equity funds from Nigerian pension funds. The participation of Nigerian pension funds in alternative investments has been facilitated by the pension reforms, which ACA supported through consultative engagements with the operators and regulators throughout the implementation process. ACA was able to launch the first Nigerian parallel vehicle in 2011, to accommodate commitments from non-closed pension fund administrators into our fund III.

Fund Manager 1

Less than 2% of our aggregate capital commitments come from pension funds. This capital is exclusively from an African pension fund based outside of Nigeria.

Fund Manager 2

There are no local institutional investors in our fund. About 90% of our fund commitments come from local high net worth investors and family offices.

Do you actively court pension funds when you fundraise? Are pension funds one of your main (i.e. Top 3) prospective investors?

Sahel Capital

We do not actively court foreign pension funds, but for the domestic pension funds we do. We have roughly US\$90 million across two funds, and we do not have any pension funds in that pool of capital - it's primarily DFI capital.

Fund Manager 1

Thus far, pension funds have not been one of our main investor groups. We understood that local pension funds were less familiar with our asset class and so we have intentionally taken our time to allow pension funds to get to know our team, portfolio and performance over our fund cycles.

We certainly think private equity has a place within the portfolios of pension funds, helping them to diversify their portfolio and generate risk adjusted, higher returns.

FUND MANAGER 1

We certainly think private equity has a place within the portfolios of pension funds, helping them to diversify their portfolio and generate risk adjusted, higher returns. We hope that in the future, pension funds will eventually be one of our top 3 investor groups.

Fund Manager 3

The participation of Nigerian pension funds at scale is critical for the sustainability of the private equity industry in Nigeria. It's also increasingly important for international investors, especially the DFIs, who express an interest in catalysing local capital to support impact and growth, as one of their strategic objectives for continuing to commit capital in our markets. We recognize the importance of our pension fund investors and prospective investors and we prioritise that in our fundraising process.

What are the major barriers to investment raised by pension funds when approached for fund commitments, and how do you respond to these concerns?

Sahel Capital

The pension funds have historically raised two concerns. The first is that they do not invest in first time fund managers, which up until recently has meant that the preponderance of Nigerian fund managers have fallen outside this bucket. The

second is that they are no longer comfortable with dollar commitments to private equity funds, given the historical impact currency devaluation has had on the Naira value of their commitments; as well as the more recent difficulty in sourcing dollars to meet capital call obligations. On the first point, when we raised our first fund in 2014 it was clear, as a first-time fund manager, it would be a challenge to convince pension funds to invest. However, as we kick-off fund raising for our Fund II this is less of a concern since we have an established track record. On the second point, we intend to offer a Naira denominated parallel investment vehicle as part of the structure of our Fund II to address this issue.

Fund Manager 1

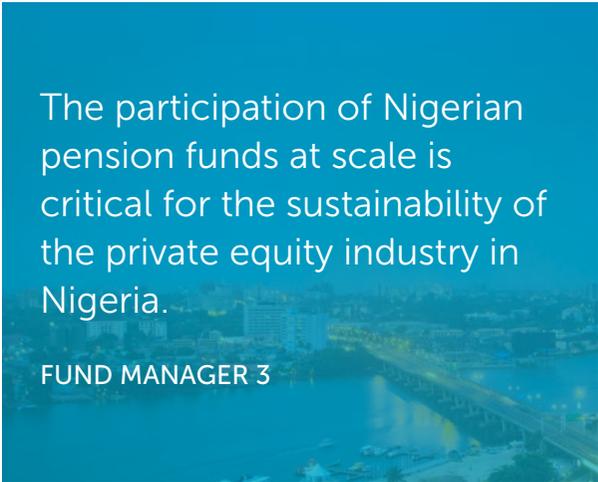
The most significant barrier has been currency. We typically manage US dollar denominated funds that are domiciled in Mauritius or Luxembourg. Existing currency restrictions for local pension funds creates a challenge, requiring us to have a parallel local currency fund. That is not impossible, but it's quite tricky to manage two funds denominated in different currencies.

Fund Manager 3

The feedback we receive indicates that the primary barriers are the level of comfort with the riskiness and long-term profile of returns in PE, as well as the currency risk associated with what has typically been a USD commitment in a private

equity fund. There is also the ongoing capacity building to do due diligence on PE funds and managers, however a lot of progress has been made in this regard. Pension funds have also expressed a challenge in their ability to benchmark the private equity investment opportunities against all the other options that they allocate to in their portfolio. They have indicated a need for PE managers to proffer a more diverse range of products that are tailored to the local market, beyond the traditional PE fund structures.

We continue to work with industry bodies to support training and capacity building for pension fund operators. We have also been responsive in seeking to provide options for commitments via local currency funds.



The participation of Nigerian pension funds at scale is critical for the sustainability of the private equity industry in Nigeria.

FUND MANAGER 3

Private equity funds, which typically have a lifecycle of 8-10 years, are relatively illiquid investment instruments. Is the long-term nature of the asset class compatible with the returns requirements and liabilities of pension funds?

Aruwa Capital Management

There's the best compatibility. They have long term assets and they need long term liabilities. It matches so perfectly, which is why it's so disappointing that they're not investing in the asset class.

Sahel Capital

That's a tough question to answer. In general, I would argue that the structure of private equity makes sense for pension funds, because they're investing over a long-term horizon. So, it matches very well, especially when you think about international markets. However, from a Nigerian context, where short term volatility and medium-term volatility is so high, I can understand why it's hard for many people to mentally commit to a 10-year horizon.

Fund Manager 1

I think they owe it to their clients - the pensioners - to provide a portfolio with diversification and returns. And I think private equity ticks both of those buckets for them. So, I don't think that pension funds and private equity are incompatible. Rather, private equity is a complementary addition to pension portfolios.

Nigerian pension funds typically make local currency capital allocations. Does the currency of pension fund investments, particularly given the high volatility of the Naira, pose challenges for pe fund managers that typically fundraise in USD?

Aruwa Capital Management

We would be willing to take on the challenge if we had the capital from the PFAs because a parallel local currency vehicle can be managed. We would make sure that the Main USD Fund and the Naira Fund co-invest on a pro-rata basis in the same Nigerian investments, we proposed something similar to the PFAs in my previous fund but there just wasn't enough interest. However, having said this, it becomes more of a challenge when you have Pan African funds investing in multiple countries outside of Nigeria.

The structure of private equity makes sense for pension funds, because they're investing over a long-term horizon.

SAHEL CAPITAL

There's the best compatibility. They have long term assets and they need long term liabilities. It matches so perfectly.

ARUWA CAPITAL MANAGEMENT

Sahel Capital

When pension funds make a local currency allocation, it translates into an implicit dollar commitment into the private equity fund. And if currency moves, their dollar commitment remains the same, but their Naira balance sheet allocation then moves dramatically. Some pension funds have stated they will be more comfortable if it was a Naira Fund or a Naira vehicle. However, stating that they are comfortable with it doesn't necessarily mean they would invest in the asset class. Our strategy for our next fund will be to approach the PFAs and give them the option to invest in a parallel Naira denominated vehicle.

Fund Manager 3

Currency volatility is a major inhibitor. We've been told categorically by a few investors that they will not be able to make allocations to a USD denominated vehicle going forward. So, if that's the only option on the table, they will not even look at it.

Which, if any, of the quality requirements and investment fund regulations established by the National Pension Commission have problematised your ability to seek capital commitments from Nigerian pension funds

African Capital Alliance

We have been able to work well within the PenCom regulations across all our funds. However, we would like to see more flexibility around pension funds' ability to invest outside of Nigeria, particularly as geo diversification becomes more critical to manage macro risks and in continuing to provide attractive returns to the pension funds.

Sahel Capital

PenCom's investment fund regulations are relatively straightforward. In my view, it's the softer issues that are more important. The harder issue is getting the Management Team and the Board to be comfortable and willing to allocate money to private equity, even though they are aware of the opportunities in the asset class. With that said, the one regulatory issue that does raise questions for international fund managers is the requirement for fund managers who want to raise capital from Nigerian PFAs to be registered with SEC and to have N150 million in share capital. The registration with SEC is not necessarily an issue, but the capitalization requirement is significantly higher than in other jurisdictions.

Fund Manager 1

Local pension fund managers are evaluated based on valuations of their portfolio, favouring liquid assets which are marked-to-market on a daily basis. Illiquid assets are harder to value and are effectively penalised, which works against potential allocations to private equity.

Fund Manager 2

I believe according to PenCom, PFAs can only invest in funds that have DFIs in them. This a restriction that has to be removed as it puts a burden on local fund managers that is outside of their control. PenCom, the PFAs and the Fund Managers should hold education sessions and maybe invite the DFIs to teach PFAs how to do due diligence on private equity funds as they remain new to the asset class, rather than saying only invest in funds that have DFIs. DFIs' commitment in Nigeria based funds are not that many every year although there are a lot of local funds that are viable and this is the role that local institutional capital providers should be playing.

The restrictions placed on fund managers themselves have problematised seeking capital commitments from Nigerian pension funds. The restriction to get a SEC licence is fine. However, fund managers should not spend money on getting the licence unless there is an explicit commitment from PFAs. What discourages a lot of fund managers from going through that process is the cost and the requirements that have to be in place before you can even approach PFAs. Another challenge is the time that it takes to get a SEC fund manager licence which can take anywhere between 12 to 18 months.

We would like to see more flexibility around pension funds' ability to invest outside of Nigeria, particularly as geo diversification becomes more critical to manage macro risks.

AFRICAN CAPITAL ALLIANCE



The Allocator Perspective:

An interview with a Nigerian Pension Fund Administrator

Only 0.03% of pension assets, which were valued at over US\$29 billion in January 2021, have been allocated to private equity. Is the asset class attractive to pension funds in Nigeria?

From the perspective of an asset class, it is attractive. From the perspective of an asset class in Nigeria, I don't think it's as attractive.

What are the main reasons for your positive or negative perception of the attractiveness of the asset class?

PE Fund Managers come in to pitch their funds, and I think a majority of the experience that you get from these Fund Managers is not really based in Nigeria, or Africa specifically. There is a challenge with these kinds of funds, as going forward they might not be able to navigate the terrain effectively.

Secondly, another thing we have discovered is that PE Fund Managers lack creativity when it comes to selling the product. Most of the time what is presented are provisions that are favourable to PE Firms and not favourable to Pension Funds as the investors - they don't carry us along. And, sometimes, they present returns that overly exaggerated. They don't have the data to back such returns (often disclosing their gross returns rather than their net returns).

What are some of the conditions you would like to see implemented from the private equity fund managers that approach you that are more favourable to pension funds?

One of the things we would like to see is more local experience. Private equity firms ought to hire grounded and sound professionals in the country they are dealing with, especially in Nigeria, who understand the terrain. Overall experience also has to be top notch. Combining their Nigerian and their international experience, the ideal would be about 20 years combined experience.

I also think private equity firms need to have more forums with the pension funds in Nigeria. If you want an investor's money, you need to carry the investor along. This is so that the provisions expected from pension funds can be discussed and fashioned jointly: meeting in the middle to agree on provisions that are equally favourable to investors.

We would also like to see more transparency when it comes to overall investments - even after the investments have been made. Regular meetings to carry investors along with plans and future opportunities in the fund. Most of the time, after the first or second meeting where fund managers introduce the product, you have to ask for meetings or updates. When there's a long-term play, even if you make losses in first or second year, you can build confidence with investors if you are transparent and carry us along every step of the way.

What regulatory developments would encourage Nigerian pension funds to increase their allocations to private equity?

From the regulatory perspective, I think PenCom's investment regulations are okay. Regulations can always change in the future, especially if we see increased investment to private equity. But as we speak, the regulation is okay. It's just our perception of the asset class that is the challenge.

Unlike traditional instruments such as Bonds or Commercial Paper which offer predictable returns, returns on private equity investments typically follow a J-Curve and are slower to mature. Do PFAs have a preference when it comes to the maturation of returns when investing in alternatives?

We're a long-term fund ourselves. Most of the time, when we're evaluating PE investments, say maybe 10 years for example, we know it goes through a J-Curve. What we do is evaluate that against comparative alternative instruments and see what we are likely to get from alternatives, versus the expectation from the PE funds.

We basically look for returns that are above inflation. And secondly, we expect the returns to be competitive. Competitive both in the private equity space, and also equal to or better than alternatives. The most important factor for us is returns above inflation.

Private equity fund managers are experts in what they do. Buying into a private equity fund means we are buying into the expertise of the Fund Manager.

NIGERIAN PENSION FUND
ADMINISTRATOR

Investments of pension fund assets are subject to approval from the Investment Strategy Committee and Risk Management Committee of a given PFA. However, once capital is dispensed to PE funds, individual investment decisions are ultimately at the discretion of the PE fund manager. Has this distance from the decision-making process of how PE funds dispense allocated capital been a barrier to PE investment in your organisation?

I don't think the distance from the decision-making process has been a problem. Private equity Fund Managers are experts in what they do. Buying into a private equity fund means we are buying into the expertise of the Fund Manager. The distance is not really a problem to us, as long as there is transparency.

As custodians of public funds, how does the risk appetite of African pension funds differ to those of other institutional investors? How do PFAs evaluate and manage risk in their pursuit of portfolio diversification?

Institutional investors can be categorised based on their investment strategies, but the underlying principle is some institutional investors are taking risky bets while others are not, based on the kind of investors or clients they have. I would say this investment principle is the same for pension funds in Nigeria.

There are various types of pension funds in Nigeria, categorised according to age. Those close to retirement will be placed in a specific fund. Definitely, the risk appetite for that kind of fund is lower, which informs the structure of asset class we need to invest in for that portfolio. There are also funds, for example Fund I, for the extremely young - those just starting out. These can allow for risky investments because they still have time on their hands before retirement. So that portfolio has a higher level of risk compared to the first one I mentioned.

The investment principle for institutional investors and what we as PFAs are doing (based on the age and risk profile) are basically the same thing. But from our perspective, we've been able to separate them by age, which gives different levels of risk tolerance. This informs how we structure the portfolio and the different risk measures we put in place.

Conclusion

Pension Funds and Private Equity in Nigeria



The Industry:

Nigerian pension funds have grown exponentially in both size and value in recent years, and have a significant role to play in the sustainability and development of local capital markets. Portfolio ceilings on pension investment in private equity (5%) means that ₦615 billion (over US\$1.5 billion) of pension fund assets may be unlocked to invest in private equity funds. However, only a fraction of this is trickling into the private equity industry. As at December 31st 2019, the Nigerian pension industry had committed ₦35.48 billion (over US\$92 million) to private equity funds, the equivalent of only 0.29% of total pension fund assets. Despite supportive regulatory reform in recent years, this growing source of domestic capital is not being harnessed at its full potential.

The Regulator:

Presently, the National Pension Commission has not imposed a mandatory requirement for pension funds to invest in alternatives, but has made a concerted effort to encourage pension fund managers to diversify from traditional investments in government bonds and listed equities towards new asset classes and geographies. Most industry stakeholders view the current regulatory environment and the investment guidelines issued by the National Pension Commission as conducive for investment in alternative asset classes. There is, however, a perceived disconnect between this regulatory enthusiasm and the individual investment preferences of Pension Fund Administrators, which are viewed as being insufficiently incentivised to invest in private equity. Additionally, the regulatory requirement for 60% of PE Funds to be invested in companies or projects within Nigeria poses a slight barrier for fund managers with a pan-African geographic focus.

Although local fund managers recognise the unique placement of pension funds as a sources of stable, long-term financing, local GPs are hesitant to climb some of the hurdles that come with courting pension investment in the absence of explicit commitments from Pension Fund Administrators.

Pension Fund Administrators:

As custodians of public finances, Pension Fund Administrators are inherently risk averse. In addressing the factors that influence their willingness to invest in private equity, more needs to be done to understand the unique perspectives, preferences, risk appetite and return expectations of Nigerian pension funds. Specifically, there is a need to create forums that support knowledge exchange between industry stakeholders, enabling long-term relationships to be built. This opens an arena for pension funds to assess if and how private equity fits within their overall investment strategies, whilst also creating an avenue for private equity fund managers to highlight the opportunities present within the industry.

That said, these partnerships need to extend beyond the initial stages of fundraising; maintained throughout the lifecycle of a private equity fund. In recognition of the value Nigerian pension funds place on clarity and transparency when considering capital commitments, private equity fund managers equally ought to prioritise regular reporting and results sharing with domestic pension funds. This transparency lays the foundation for relationships of trust to be built, where pension funds become more familiar with and confident in the asset class, viewing it less as a blind pool.

Private Equity Fund Managers:

Private equity fund managers in Nigeria recognise the capital-raising opportunities domestic pension funds represent and are eager to engage with local Pension Fund Administrators. Although local fund managers recognise the unique placement of pension funds as a sources of stable, long-term financing, local GPs are hesitant to climb some of the hurdles that come with courting pension investment in the absence of explicit commitments from Pension Fund Administrators. Examples include the requirement to register with the Nigerian SEC, the need to raise parallel local currency vehicles to accommodate Naira-based capital allocations, and the hesitancy exhibited by pension funds to invest in first-time fund managers. Although these hurdles are by no means insurmountable, they do pose a challenge for fund managers, particularly smaller private equity firms perhaps raising their maiden fund.



RESEARCH METHODOLOGY

Survey

AVCA surveyed 15 Pension Fund Managers in Nigeria between August and September 2021: 12 Pension Fund Administrators (PFAs) and 3 Closed Pension Fund Administrators (CFPAs). The survey respondents collectively manage pension assets amounting to ₦7.6 trillion (over US\$19.0 billion) as of December 2020, representing 82% of the total value of pension assets managed by PFAs in Nigeria. The survey was undertaken via an online questionnaire and incorporates the views of Pension Fund Managers currently invested in PE in Nigeria, as well as those planning to make their first investments in the near future. The survey questions were designed to interrogate the views, plans and expectations of Pension Fund Managers about the PE industry in Nigeria specifically, as well as African PE more generally. Only AVCA researchers involved in the project had access to disaggregated data, which were kept strictly confidential.



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Championing Private Investment in Africa

The African Private Equity and Venture Capital Association is the pan-African industry body which promotes and enables private investment in Africa.

AVCA plays an important role as a champion and effective change agent for the industry, educating, equipping and connecting members and stakeholders with independent industry research, best practice training programmes and exceptional networking opportunities.

With a global and growing member base, AVCA members span private equity and venture capital firms, institutional investors, foundations and endowments, pension funds, international development finance institutions, professional service firms, academia, and other associations.

This diverse membership is united by a common purpose: to be part of the Africa growth story.

Pension Fund Operators Association of Nigeria (PenOp) is an independent, non-governmental body established to promote the operations of the pension industry, provide for self-regulation and ensure that international best practices relating to the industry are observed by the operators registered in Nigeria. PenOp is the umbrella body for all licensed pension fund operators operating in Nigeria

Its role internally, is to add value to its members across all levels via information, education, visibility, networking, strategy, product development, etc. Externally its role is to increase the awareness and visibility of the pension industry and enable external stakeholders understand and participate in the development of this financial sub-sector wherever and whenever possible.

