EIGHTEEN EAST

MOBILIST

THE EXIT-MOBILISATION OPPORTUNITY IN AFRICA

MARCH 2021

Foreign, Commonwealth
& Development Office

Eighteen East is grateful to the United Kingdom's Foreign, Commonwealth & Development Office (FCDO) for their support of this research report and for their ongoing commitment to unlocking SDG financing through the 'Mobilising Institutional Capital Through Listed Product Structures' (MOBILIST) Programme.

Foreign, Commonwealth & Development Office

We would also like to acknowledge the following organisations for their contributions in developing the content of this report:

AfDB, African Alliance, African Venture Capital Association, Allianz Global Investors, BA Pension Investment Management, Border to Coast Pensions Partnership, Cazenove Capital, CDC, Church Commissioners, DFC, FMO, ICEA Lion, IFC, KEPFIC, Legal & General, London Stock Exchange Group, Mercer, Norfund, NSSF, Obviam, Pencon, Pensions for Purpose, PIC, PIDG, Proparco, Snowball, TDB Group.

TABLE OF CONTENTS

EXECUTIVE SUMMARY

'Exit-mobilisation': where a DFI or MDB exits an investment through a public listing, or another form of sale to commercial investors.

– FCDO, 2020

Exit-mobilisation sits squarely within the Mobilisation Policy workstream the UK's Foreign, Commonwealth & Development Office (FCDO) has initiated within its 'Mobilising Institutional Capital Through Listed Product Structures' (MOBILIST) programme.

MOBILIST seeks to address some of the most compelling issues preventing capital formation in public markets for the financing of the United Nations Sustainable Development Goals (SDGs). Exit-mobilisation specifically has, through the mobilisation of new and additional sources of private capital and the concurrent recycling of the scarce public funds at the disposal of development finance institutions and multilateral development banks (collectively 'DFIs'), the potential to accelerate the flow of capital towards investments conducive to the achievement of the SDGs.

The purpose of this study is to assess the feasibility of and the hurdles to the implementation of exit-mobilisation to investments made by DFIs in sub-Saharan Africa.

It was in a first instance necessary to catalogue and categorise these investments. To be effective, exit-mobilisation cannot merely be a one-time intervention but must be integral to the development finance business model. The map drawn here therefore sought to chart commitments made by DFIs across sectors, instruments, and geographies over the last decade. The USD 45 billion worth of commitments it is comprised of paint a clear and coherent picture and provide a sound foundation for the analysis of the exit-mobilisation opportunity.

Although the repartition is not uniform across institutions, debt dominates the aggregate landscape with close to 80% of the amounts reported as having been committed by the sample of DFIs studied over a ten-year period ending in December 2019. The remainder is split between commitments to private equity and private debt funds and direct equity investments. Of the loan commitments, 45% are destined to financial institutions, and over 30% to the energy and extractives sector, dominated by renewable energy generation. The prevalence of hard currency denominated investments is enough to make the occurrence of direct local currency funding statistically negligible. The pricing of these loans offers no surprise and the transparency afforded by mandatory financial reporting disclosures suggest defaults have, over the period, posed no lethal threat to lenders. The cloak of secrecy that is the traditional adornment of private equity fails to conceal disappointing aggregate performance numbers nuanced by the dispersed contribution of individual funds.

Bringing East African banks and energy infrastructure assets into focus, the levels of sector and country concentration observed at first glance translate into individual situations where development finance often accounts for all but the smallest portion of long-term debt financing, often in sectors theoretically best suited to the exit-mobilisation process. Equally relevant is the relatively advanced level of financial markets infrastructure observed in these geographies, which provides the environment for south-south exit-mobilisation.

Crossing over to the investor side, engagement with African institutional investors and their UK-based counterparts uncovered contrasted and complicated realities. Whilst the former have a documented and urgent need for increasingly diversified exposure to their own economic growth, only stymied by their own risk aversion and the lack of investible products, the latter have yet to materially acknowledge Africa as an investment destination. Importantly, their respective investment universes are key determinants of what they consider as the 'market returns' required to deploy capital on the African continent. This in turn shines a light on the fact that the 'concessionary' nature of an investment is in the eye of the beholder and measured against the universe of risk-return opportunities to which an investor has access.

Whilst the report contains learning relevant to developing countries in general, there is no doubt that exit-mobilisation faces challenges specific to the African context. There are however precedents for the successful listings of the equity or debt of DFI-backed African businesses, and conversations with investors unearthed clear and present areas of opportunity. The post-construction phase sale of DFI loans to infrastructure projects was for example identified by several African institutional investors as attractive and given the momentum behind renewable energy assets observed on the London Stock Exchange, tapping what is a large portion of DFI deployments could represent a logical first foray where UK and international investors are concerned.

The instruments of exit-mobilisation already exist and a relevant, if non-exhaustive, menu of options is contained in this report as are their potential applications to the two main areas of intersection between DFI capital concentration and investor demand.

The main obstacles to exit-mobilisation are however neither technical in nature, nor necessarily likely to primarily result from a lack of investor appetite.

Although exit-mobilisation should always have constituted the long-term objective of development finance policy, the reality is that it is today often misaligned with the operational cycles of the institutions tasked with its delivery. Its advent requires both a realisation of the inherent opportunity and a change of direction. It is incumbent on those institutions able, through ownership or governance, to set their course to ensure that DFIs are given clear strategic direction, are adequately incentivised, equipped, and resourced to take on this new and promising challenge.

Exit-mobilisation is a market building exercise, and markets are built on access to information, thrive on standardisation, and live through the interaction of self-motivated actors. There are many levers that MOBILIST can activate to facilitate its success.

Exit-mobilisation has the potential to leverage off capital markets, and to harness the power of the public markets in particular, to deliver the full potential of the unique origination and capital deployment capacities built by development finance institutions over decades, thereby accelerating the pace of our common, necessary journey towards sustainable development.

1. MAPPING DFI ASSETS

1.1. METHODOLOGY

1.1.1. Mapping Methodology

A Multi-Dimensional Map

Time is an important dimension in any investment context. In undertaking the exercise of mapping investments made by development finance institutions (DFIs)[1] in sub-Saharan Africa, it is important to keep in mind that the purpose is to illustrate the opportunities that are relevant in the context of private capital mobilisation. This process will not take place overnight, and long-term allocations are not assessed by institutional investors on the basis of one-off investment opportunities. Investments should be seen as flows rather than as stagnant pools. What investments have been made in the past and what future pipeline of investments can be inferred from them?

This map of African DFI investments is drawn up through the observation of long-term patterns. It does not aim to capture a still snapshot of a movement at an arbitrary point in time, but rather to depict how, whereto and to whom DFI capital is extended across the years.

The extraction and compilation of the underlying data was as a result focussed on identifying the commitments made by a statistically significant group of DFIs over the past decade. Therefore, some of the investments recorded have since reached maturity, some projects have been refinanced, and some facilities have been renewed. This again is but a representation of the ebbs and flows of investments that are integral to the analysis of any long-term investment opportunity. It is important to keep in mind that given the difference in the average tenor of different categories of investments, this is likely to result in a picture skewed towards loans, as private equity funds for example have a longer investment cycle.

The precise use of the ‘commitments’ terminology is important. While in the case of direct equity investments, bonds and vanilla loans, the value of a commitment and that of the resulting investment are most often interchangeable, facilities issued to financial institutions are drawn over time according to need and opportunity, as are commitments made to private equity limited partnerships. DFIs are as a result generally in complete control of neither the timing, the eventual actual quantum of their investments, nor in the case of private equity of the pace at which capital is returned.

Mobilised private investors will be confronted with the same reality, and it was therefore determined that the relevant data point for this exercise is the commitment initially made by DFIs rather than the actual exposure at an arbitrarily selected point in time.

1 For the purposes of this report, and except where explicitly identified, the term DFI is used to include multilateral development banks (MDBs)

Data Challenges

The very relevance of this exercise is linked to the scarcity of data pertaining to development finance investments. It is not the intention here to add to the much-aired grievances regarding the lack of transparency plaguing the sector. It is in any event both inaccurate and unfair to tar all DFIs with the same brush since their approaches in this regard differ significantly.

It is however necessary to highlight some of the challenges faced by the DFI investments cartographer.

Most institutions do maintain a disclosure programme focussed on their commitments and/or their current exposure. The main issues associated with their analysis include:

Quality:

- The data is often of poor quality, with obvious clerical mistakes widely observable. These range from a few additional zeros to an amount, to claims of the entire amount of an investment jointly made by a group of DFIs.
- The reported commitment is sometimes the one considered at the beginning of the negotiation process rather than the number eventually agreed upon.

Consistency:

- At the single DFI level:
    - The granularity of the information has generally improved over time, but efforts are seldom made to bring older data to the same level.
    - In many cases, the choice of reported metrics for each specific entry seems to be left to the discretion of the individual capturing the data.
- Across DFIs:
    - It will come as no surprise that there should be no harmonisation of disclosure programmes. It is however surprising to note how each DFI employs their own distinct permutation of data fields.

The performance of DFI portfolios is to this day not the subject of specific transparency programmes. The public nature of their funding, coupled with regulatory requirements, does however in some cases afford an opportunity to gain significant insight through their financial statements.

A significant share of DFI investments is in addition made to entities subject to more stringent transparency requirements than the DFIs themselves. The financial statements of these entities therefore provide high-quality data on DFI exposure and pricing.

The lack of transparency is and has always been a hindrance to the flow of capital. The secular trend towards ever more stringent reporting requirements across capital markets will eventually render any efforts at preserving confidentiality futile as well as counter-productive in the context of the development finance agenda.

There does exist across DFI teams a real consensus for higher levels of transparency.

The reality is that data compiling and subsequent disclosure are resource hungry processes that most DFIs are ill-equipped to take on.

Preserving the status quo is simply easier and cheaper. It therefore behoves the wider community to provide resources and solutions to share the burden of the much-needed transparency drive.

Statistical Relevance and Four-Pronged Approach

Several factors do mitigate the consequences of data challenges.

The noise created by instances of inaccuracy is of limited statistical significance to the output of the mapping exercise. In addition, DFIs generally invest as a club, enabling the identification and correction of such inaccuracies on the part of one DFI through the reporting of another. In similar fashion, the easily observable consistency across DFI investment patterns makes the identification of the more blatant misrepresentations reasonably straightforward.

The objective of the mapping exercise is not to create a database designed to provide details on individual transactions, but rather to deliver an aggregate map derived from individual transactions data, thereby overcoming the challenges presented by the lack of consistency and transparency in DFI reporting.

The data underpinning this mapping was compiled through a four-pronged approach combining:

- Direct outreach to and data transfer from DFIs
- Proprietary deal information compiled over the years and complemented by third-party research
- Analysis of public disclosure data from DFIs
- Analysis of the financial statements of investee entities

The process is akin to puzzle solving when the box displaying the overall picture and the number of pieces are missing. This is not impossible but extensive triangulation is required.

The work was in some instances informed by the obtaining of non-public data. To respect the confidentiality frameworks entered into by DFIs, and although aggregate performance measures are inclusive of data thus obtained, no information published in this report is a direct transcription of such data. It was at times opportune to use third-party public reports providing financial data on specific deals. This information was often less precise than that obtained 'off the record', but where it was deemed sufficiently illustrative the decision was made to include such information since an imperfect picture is better than no picture at all.

1.1.2. DFI Sample

For the purpose of this exercise, data was compiled with regards to commitments made by:

AfDB	DFC
EIB	FMO
IFC	Norfund
TDB Group[2]	Proparco
CDC	EAIF

The inclusion or exclusion of any specific institution is no assertion about its importance or the quality of its reporting. The list is the result of the necessary compromise between the need to deliver a statistically relevant sample and the resources available.

Whilst most DFIs strictly limit their investments to private entities, it is worth noting that with regards to some of these groups it was necessary to exclude investments made into public or parastatal entities, the focus of this study being on private sector and PPP investments. This data is however retained for use in future work.

1.1.3. Instruments Focus

This study is focussed on four categories of DFI investments:

- Loans, including facilities
- Direct equity investments, both private and public
- Private equity and private debt funds
- Bonds

This approach is in part informed by the private capital mobilisation agenda at the core of the MOBILIST programme. Instruments that could realistically be pooled and transferred to private investors were therefore selected.

Although theoretically feasible, the transfer of guarantees, political insurance, risk sharing agreements, interest rate swaps and other types of instruments used by DFIs is less straightforward, given their often unfunded, off-balance-sheet nature. The ability to issue such instruments is in addition restricted to a relatively small universe of private investors, and the frequency and magnitude of their occurrence is in any event such that the relevance of the research is not impaired by their exclusion. Research into the transferability of such instruments should however form the basis for further study.

1.1.4. Geographical Focus

The focus of this study is on investments made by DFIs across sub-Saharan Africa. This again is the result of a conscious compromise. Starting from a global observation of DFI performance, the report zooms in on the sub-Saharan regions of the African continent for the purpose of the mapping exercise, and finally on the East African region to provide the reader with a tangible sense of the nature of DFI investments and of the level of granularity that can be obtained through additional research work.

The focus on sub-Saharan Africa is aligned with the World Bank's (and the IFC's) regional breakdown. It is additionally recognising the inclusion of North African countries into the MENA region by some DFIs and many private investors alike. An argument could be made that South Africa should also be excluded on the basis of its differentiated economic dynamics and the more advanced development of its capital markets. In light of the resources and timeline for this study, an approach had to be adopted, but there is certainly scope for extending or adapting the geographical focus as and when further work is undertaken.

2 Given its specific nature, data pertaining to the investments made by the TDB Group were not included in the main database but are the object of a separate analysis.

1.2. DRAWING THE MAP

1.2.1. Quantum

The map is charted based on data pertaining to just over USD 45 billion of commitments reported as having been made by nine DFIs from the 1st of January 2010 till the 31st of December 2019.

MAPPED COMMITMENTS BREAKDOWN BY DFI

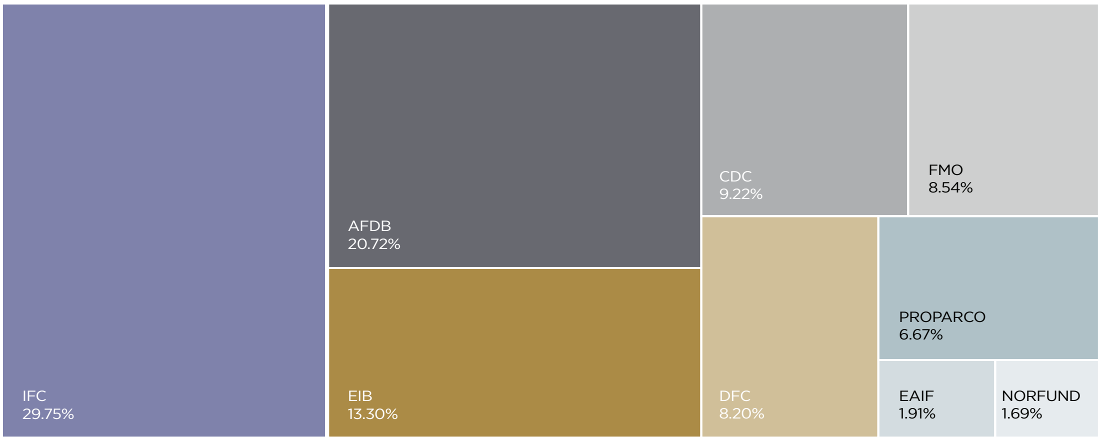


Figure 1: Mapped commitments breakdown by DFI

Figure 1 provides a visualisation of the breakdown of these commitments between these nine institutions. Unsurprisingly multilateral institutions (IFC, AfDB, EIB) together account for over 65% of commitments made over the period.

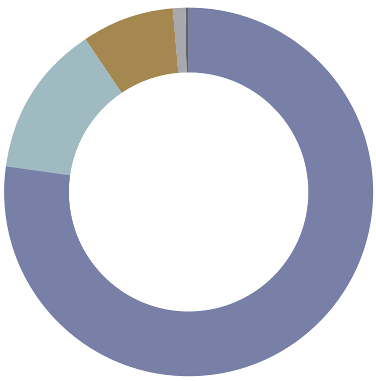
Less than 5% of these commitments were reported as having been made in local currency, two thirds of which were reported as having been made in South African Rands. US Dollars and Euros are predictably by far the dominant currencies.

1.2.2. Instruments

The analysis of the data compiled in the context of the mapping exercise confirms that, notwithstanding the previously identified effects of the relatively shorter duration of debt instruments, development finance is first and foremost a lending game. Lending accounts for over 77% of commitments made by the sample of institutions over the period, as illustrated in Figure 2. This includes term loans and credit facilities, many of the latter extended to financial institutions. It must be remembered that commitments do not always result in actual deployments of an identical amount.

On the equity front, funds account for roughly two thirds of commitments made. Here again, there is no certain direct translation of commitments to actual deployments, particularly given the high fee levels associated with the private equity model.

MAPPED COMMITMENTS BREAKDOWN BY INSTRUMENT



LOANS	77.24%
PE FUNDS	13.57%
DIRECT EQUITY	8.01%
DEBT FUNDS	0.95%
BONDS	0.23%

Figure 2: Mapped commitments breakdown by instrument

It is worth noting at this stage that the picture is far from uniform across institutions. Whilst CDC, for example only accounts for about 10% of the aggregate commitments the map is composed of, its strategic emphasis on equity means it is a far more significant player in private equity funds with circa 30% of commitments as shown in Figure 3.

MAPPED PRIVATE EQUITY FUND COMMITMENTS

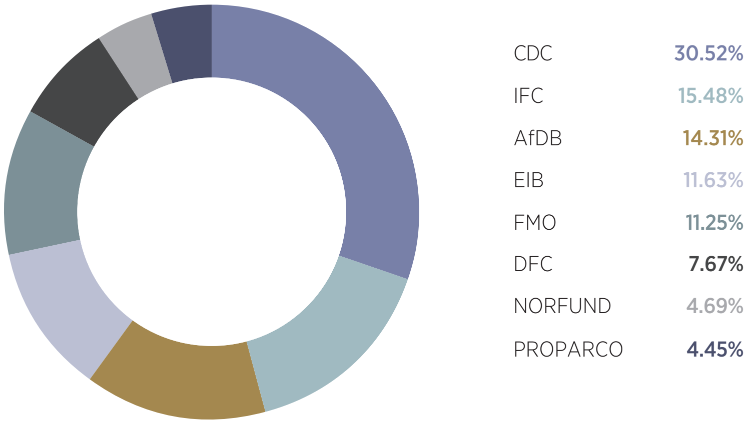
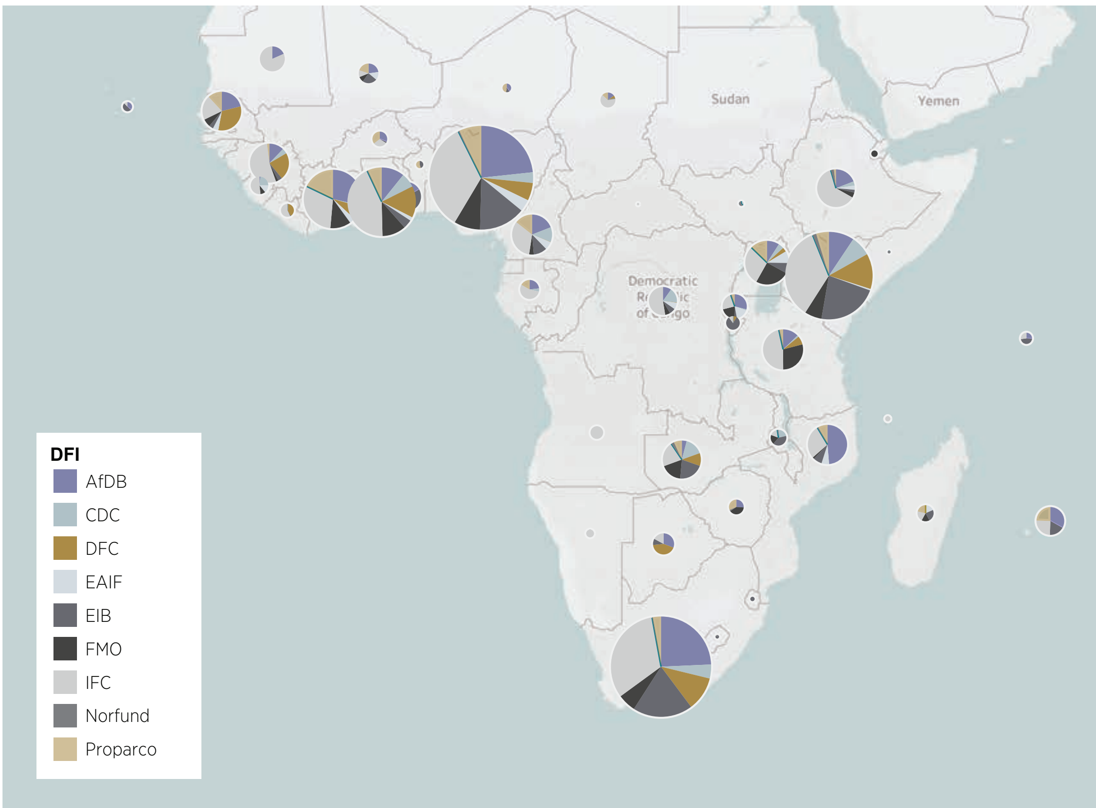


Figure 3: Mapped private equity fund commitments breakdown by DFI

1.2.3. Geography

MAPPED DIRECT COMMITMENTS BREAKDOWN BY COUNTRY AND BY DFI



Map 1: Mapped direct commitments breakdown by DFI

As the commitments map is transposed onto its geographical alter ego, clear areas of concentration can be identified around three regional clusters in sub-Saharan Africa, respectively centred around South Africa, Kenya, and Nigeria. Although South Africa attracts the bulk of commitments made to the southern African region, and 13.70% of the total, followed by Mozambique and Zambia, the picture is more balanced in West Africa where beyond the regional leader Nigeria with 13.63% of the total, Ghana (5.82%) and Côte d'Ivoire (3.62%), and to a lesser extent Senegal and Cameroon are significant recipients of DFI commitments. Kenya (9.32% of total) is a clear leader in East Africa ahead of Uganda and Tanzania. Figure 4 specifically illustrates direct (non-fund) commitments.

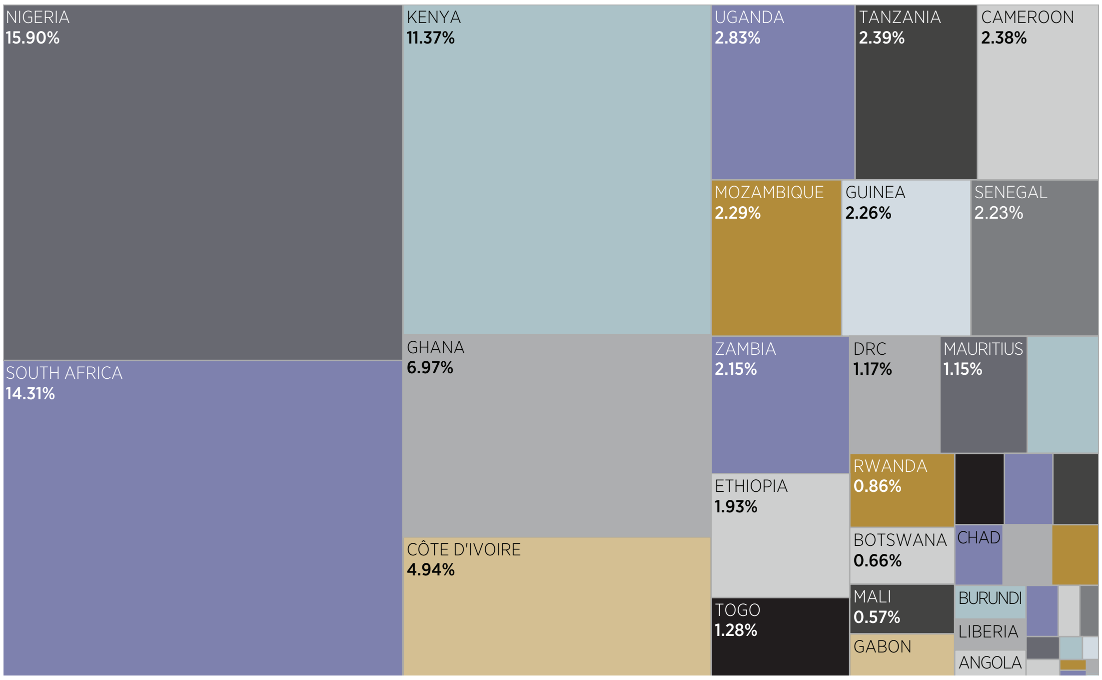


Figure 4: Mapped direct commitments breakdown by country

1.2.4. Sectors

For the purpose of categorising assets by segments, the World Bank sector taxonomy[3] was selected for this study, and the DFI commitments recorded in the main database were categorised accordingly. Even higher levels of concentration are observed when breaking direct investments down by sector.

Financials are capturing 44.76% of commitments. On-lending is a key tenet of the generally accepted development finance strategy and it should therefore come as no surprise. Importantly for the purpose of exit-mobilisation, it is noteworthy that their regulated status and the scrutiny they are subjected to by rating agencies should afford investors some level of risk mitigation.

3 Available here: http://pubdocs.worldbank.org/en/538321490128452070/Sector-Taxonomy-and-definitions.pdf

MAPPED DIRECT LOAN COMMITMENTS BREAKDOWN BY SECTOR

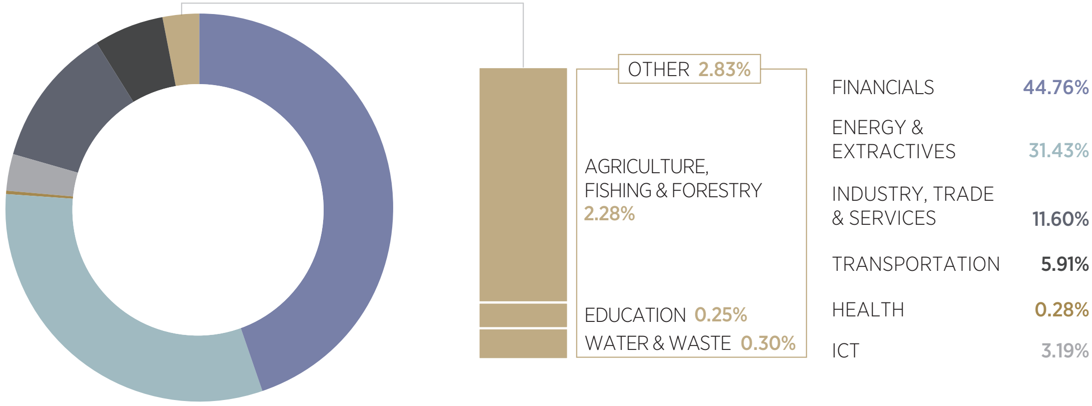


Figure 5: Mapped direct loan commitments breakdown by sector

Energy & Extractives are the second largest sector on the map, power generation being an important component of this sector in the DFI context. Renewable energy generation accounts for 46% of commitments against 23% for non-renewable energy generation.

Given the newly acquired mainstream status of the former, the significant scale of DFI commitments to the sector could represent an exit-mobilisation opportunity.

MAPPED DIRECT COMMITMENTS TO ENERGY & EXTRACTIVES BREAKDOWN BY SUB-SECTOR

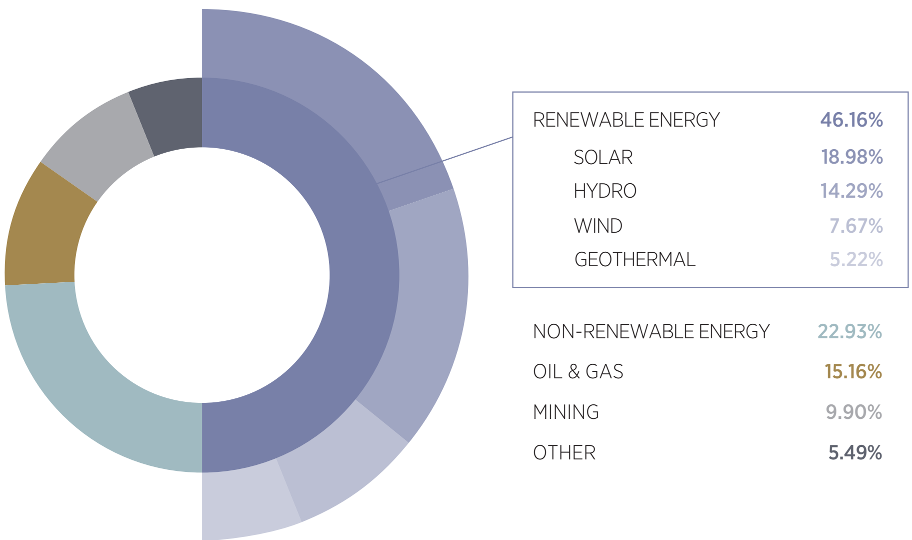


Figure 6: Mapped direct commitments to Energy & Extractives breakdown by sub-sector

1.3. LOAN PORTFOLIOS CHARACTERISTICS

1.3.1. Tenor

Loan tenor distribution is clearly linked to sectors, with shorter tenors (5-10 years) a feature of lending to the Financials & Industry and Trade & Services sectors, while infrastructure loans to the Energy & Transportation sectors display longer tenors, typically in the 10 to 15-year range. In the context of exit-mobilisation, this has the advantage of offering a consistent investment universe, a feature equally observable where pricing is concerned.

TENOR PER SECTOR

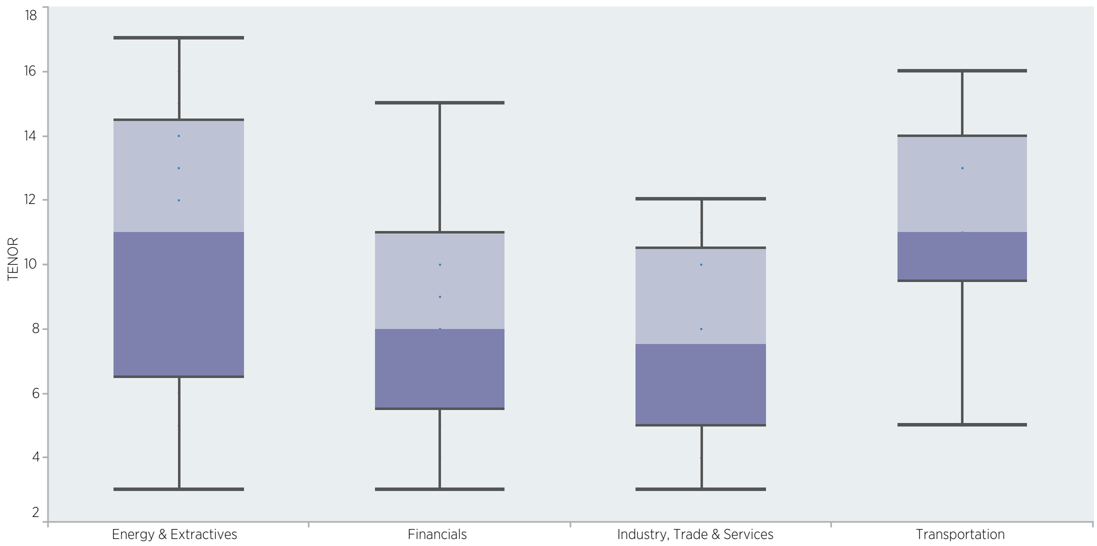


Figure 7: Loan tenor, mapped USD loans, per sector

1.3.2. Pricing

Just under 2% of loan commitments for which terms were able to be identified were extended on a fixed interest rate basis. DFIs do tend to lend on a floating rate basis, pricing being expressed as a spread over a reference rate, 3-month or 6-month USD LIBOR being the most commonly observed.

A key observation is that there is a great level of uniformity across DFI loan pricing. As illustrated by Figure 8, interest rates associated with lending to financial institutions are lower, which is consistent with a lower level of risk linked to regulated entities and the on-lending rationale underpinning DFI support. There does however seem to very little in the way of observable pricing dispersion across other sectors. In the words of one interviewed senior DFI professional “DFIs behave like mutual banks, they do not price according to risk”. Rate cards are indeed a feature of MDBs. Whist this might be seen as a negative by private investors and consequently seen as a potential barrier to exit-mobilisation, it is worth pointing out that there is also a high level of observable uniformity across the investees and projects themselves.

1.3.3. Performance

An analysis of DFI financial statements does provide a clear picture of the profitability of their lending activities. For the purpose of this exercise, it was decided to focus on the largest lenders including two multilateral and two bilateral DFIs with significant loan portfolios.

IR MARGINS PER SECTOR

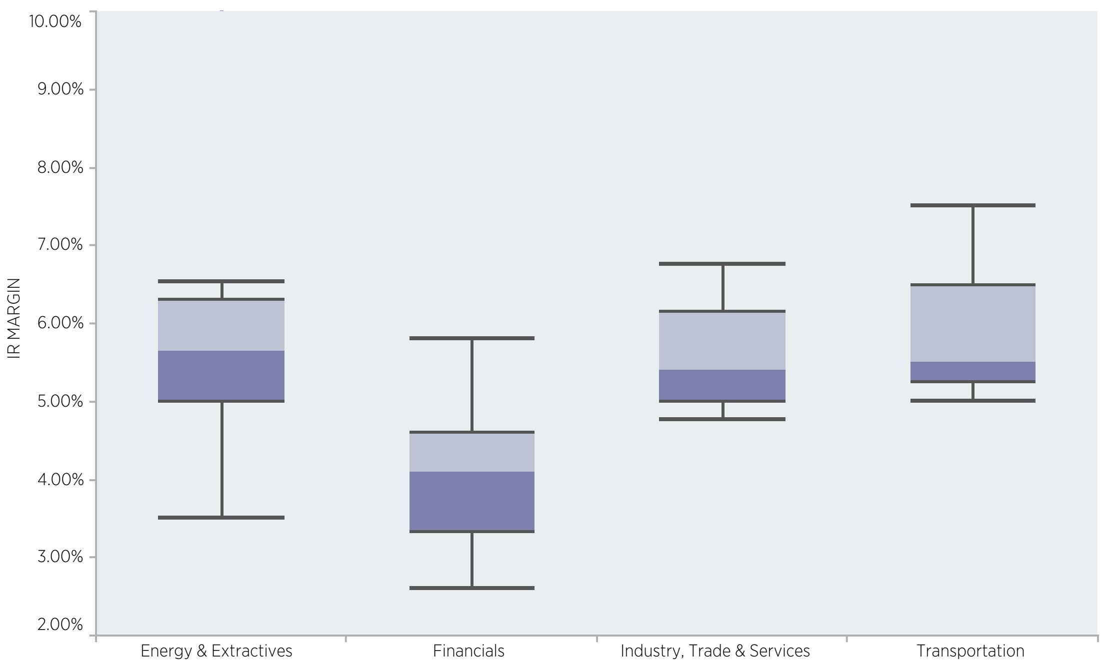


Figure 8: IR Margin over LIBOR, Mapped USD loans, per sector

Interest and related income from lending operations across selected institutions are inscribed within a relatively narrow 5.60% to 7.05% range with a non-asset weighted average of 6.20% over the last four financial years, and net impairments at -0.62%.

Unsurprisingly both interest income and impairments are relatively lower for loans to financial institutions and relatively higher for other loan recipients. In the case of one of the bilateral DFIs' financial statements, average interest income associated with loans to credit institutions thus was 4.37% for average yearly net impairments of -0.21%, and those to other clients stood at 8.03% for average yearly net impairments of -0.59%. Actual losses on principal over the period averaged at annualised rate of 0.08%.

These numbers reflect the overall performance of these institutions' lending operations, and additional work would be needed to compile a more granular breakdown on a per country, per sector basis.

The COVID crisis is unlikely to leave portfolios unscathed, but the full picture will take some time to form. Conversations held with the IFC, which on the African continent has debt commitments "close to USD 8 billion, of which almost half relates to Financial Institutions (USD 3.8 billion), followed by infrastructure assets (c. USD 2.4 billion) and the MAS (Manufacturing, Agribusiness and Services) sectors (USD 1.6 billion), with significant growth following the COVID crisis as a region that has seen significant impacts", do shed some light on the recent performance of their African debt assets:

"The risk of this portfolio is above the average for IFC, although this has not translated in significantly higher ratio for non-performing assets (albeit with substantial variations between industries based on specific sector dynamics).[4]"

4 Source: Eighteen East investor interviews, March 2021

1.4. DIRECT EQUITY PORTFOLIOS CHARACTERISTICS

1.4.1. Aggregate

204 direct equity investments accounted for USD 2.9 billion of the commitments analysed for the purpose of this study. The consistent pattern of high levels of concentration is once again observable, with 10 companies in receipt of the largest aggregate commitments adding up to USD 1 billion. These include Globeleq, the Guernsey registered independent power producer owned by CDC (70%) and Norfund (30%), Econet's subsidiary Liquid Telecom, CDC's unsuccessful USD 144 million investment in Kenya's ARM Cement and Zambia's stock exchange listed meat company Zambeef.

1.4.2. Sectors and Geographies

Direct equity investments present a more diversified sectoral allocation picture. Whilst Energy & Extractives still account for close to 35% of commitments made over the period, Financials only represent 15% and Industry, Trade & Services are the second largest sector with 18% of commitments. With regards to geographies, the same three countries (Nigeria, South Africa, and Kenya) are still dominant, with Kenya at the receiving end of 16% of commitments. It is however worth reiterating that entities registered outside of Africa received some of the largest direct equity commitments made by the sample of DFIs.

MAPPED DIRECT EQUITY COMMITMENTS BREAKDOWN BY SECTOR

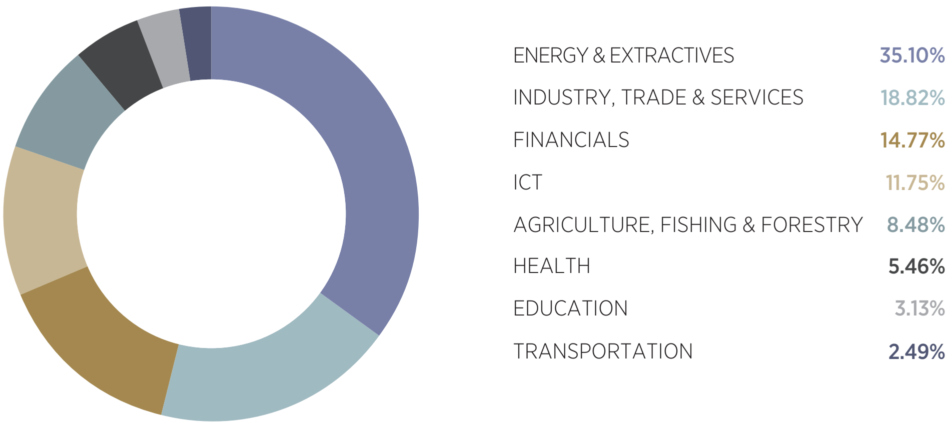


Figure 9: Mapped direct equity commitments, breakdown by sector

1.4.3. Performance

The performance of those investments made in listed entities is readily observable and has suffered through the recent multi-year African equity bear market. The valuation of privately held businesses as reflected in DFI data is neither frequent nor necessarily reliable, as it faces similar challenges to those associated with the valuation of private equity funds portfolios.

1.5. FUNDS PORTFOLIOS CHARACTERISTICS

1.5.1. Field and Domiciliation

Whilst Figure 10 seems to suggest commitments have over the period been made to a wide array of funds, there is a significant level of concentration on a few large asset managers. 20% of the fund commitments listed in the database were made to five groups. The data in addition confirms a high degree of loyalty from individual DFIs to individual asset managers, with commitments being made to each fund raised by the asset manager.

Mauritius is the domiciliation jurisdiction of choice for the majority of funds. It is home to 50%, or some 81 of the funds captured in this analysis. Other offshore financial centres (OFCs) are also used, including the Cayman Islands (4.9%), Luxembourg (4.9%), and Guernsey (2.5%).

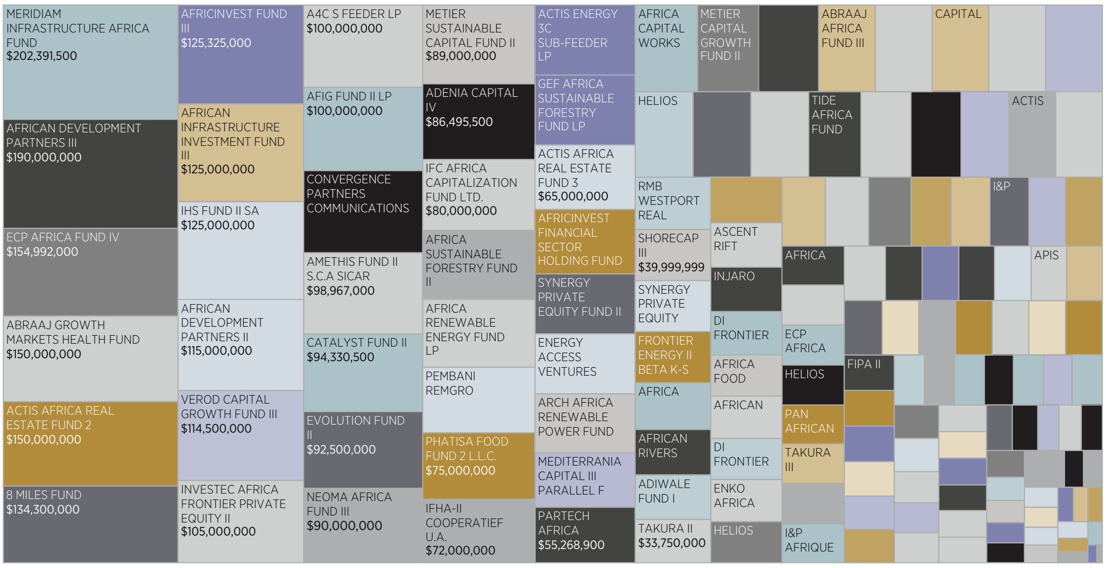


Figure 10: Mapped private funds commitments

The second most commonly utilised jurisdiction is South Africa at 8.6% of observed funds. The United Kingdom, the Netherlands, and France account for 3.7%, 3.7%, and 2.5% respectively.

This is in line with the long-standing DFI practice of investing through OFC domiciled fund structures. A frequently mentioned explanation is that these funds' countries of operation typically have poorly developed market and legal infrastructure and as a result private investors would be less inclined to participate if they were domiciled in such jurisdictions.[5] The low level of private capital being mobilised into these funds does somewhat undercut this rationale. Consequently, this approach should be the subject of further scrutiny as the use of OFCs is often contrary to the spirit of OECD countries policy and risks undermining the development finance sector.

An important observation is that OFC domiciled funds are considered as non-domestic assets for many local African institutional investors.

1.5.2. Returns

Measuring Private Equity Returns[6]

Measuring and accurately representing private equity returns is notoriously difficult. This is in large part due to the complex cash cycle, the lack of transparency and the challenges to the accurate interim valuation of investments. The need to compare funds that have not gone full cycle (i.e. called, deployed, and then returned all capital to to investors, or limited partners (LPs)) means that a variety of metrics are used. The most widely used of these is the internal rate of return (IRR), which looks at all cash flows over a given period. While useful in generating a robust measure of the complex cash flow cycle, the timing of distributions to LPs, the comparative performance of early versus later exits by the fund manager, or general partner (GP), and the relative scale of investments all make the comparison of IRRs across funds problematic and often misleading.

Money (or cash) multiples that seek to compare the capital paid into the fund by investors with that which has been returned provide a simple measure of actual fund performance over the life of the fund. They are however of limited use in the early life of the fund when drawdowns are being made, and without knowing the duration of investments prove inconclusive when measuring relative fund performance.

5 Source: ODI: Why do Development Finance Institutions use offshore financial centres? 2017
6 Sources: INSEAD: Measuring Private Equity Fund Performance, 2019; CFA Institute: https://blogs.cfainstitute.org/investor/2020/02/13/decoding-private-equity-performance/

Public market equivalent (PME) measures retrospectively recreate the performance of a private equity fund by hypothetically investing its drawdowns in equivalent public market strategies. Done correctly, a useful like-for-like comparison can be made but selecting the appropriate public markets indices is essential – and in the context of development finance such comparables are rarely available. All methods in addition show large deviations when presented as gross or net of fees.

Even when the data is available, and markets are relatively mature, it is difficult for investors to get a clear picture of private equity returns. Conversations held with academic experts further suggest that DFIs do not always maintain performance data for their portfolios of private equity funds in a format that allows robust analysis.

The Need for Transparency

Another key factor in the difficulty in assessing private equity performance is the universally low levels of transparency associated with the sector. This is true of the development finance field as it is of traditional private equity. GPs favour a high degree of confidentiality pertaining to their investment strategies and processes, and this tends to pervade contracting documentation to the extent that LPs are typically bound to withhold information pertaining to their investments, ranging from fees to financial performance. Eighteen East is working with the Wharton Social Impact Initiative on a research project designed to assess the use of confidentiality provisions in the DFI private equity contracting documentation and through this work can confirm that this is observable in development finance where DFIs typically point at contractual barriers to the sharing of fund information.

It is worth noting that data pertaining to traditional private equity returns is available to researchers and other purchasers from established data providers such as Cambridge Associates, Prequin, and Burgiss. The establishment of such data repositories, designed to facilitate both the production and sharing of high-quality performance data, would appear to be a logical and potentially crucial next step for the growth of the development finance private equity market and the mobilisation of private capital at scale.

The private equity model presents several challenges to the mobilisation of private capital at scale but cannot be ignored as an essential tool in the delivery of supportive, long duration risk capital to impactful businesses and projects that would otherwise be unable to fund their growth. The use of private equity structures by DFIs and other impact investors has enabled this flow of capital over several decades and has played a cornerstone role in the establishment of increasingly capable and diverse sets of fund management networks across the African continent.

However, if essential transactional information – including historical returns – is systematically kept behind extensive confidentiality provisions the opportunity to mobilise private capital at scale will remain elusive.

Private Equity Returns in Development Finance

In attempting to measure of the performance of private equity investments held by DFIs, several approaches to obtaining and presenting data were adopted. These include the assessment of available performance data published in industry reports, an analysis of available indices, and non-public fund performance information obtained by Eighteen East.

It should be noted that whilst it is beyond the reach and scope of this research exercise to describe comprehensive and definitive development finance private equity returns data, the information below attempts to lay out available returns information for the purposes of guiding the conclusions and recommendations made later in the report.

Publicly available performance data suggest net USD long term IRRs in the low to middle single digits:

- In 2017 the Africa Private Equity and Venture Capital (AVCA) and Cambridge Associates released an index comprised of 51 African private equity funds formed between 1995 and 2015. The report shows a 10-year pooled IRR (net of fees) of 3.68% for all funds. It should be noted that the sample used in the report excludes real estate, forestry, and infrastructure funds.

- In 2019, the Omidyar Network and the Shell foundation conducted an analysis of fund investments data volunteered by five development finance investors, including the IFC, CDC, and Obviam (SIFEM). The dataset covers some 365 funds, including 129 from Africa. Funds are split into types, including private equity funds with exposure to SMEs (median ticket size of USD 6.6 million) and private equity funds without (median ticket size of USD 14.5 million). For these two categories the 15-year pooled IRR (net of fees) figures are 4.29% and 1.96%, with TVPI figures of 1.15 and 1.19, respectively.[7]

The use of indices is pertinent to assess the performance of private equity fund investments made by DFIs because, from a statistical relevance standpoint, DFIs as a group invest in the majority of African private equity funds. Whilst individual DFI portfolio performance will differ due to fund selection, allocations to vintages and assets growth path, in aggregate they are the market, and their collective performance will therefore be that of the market.

Non-public performance data obtained for the purpose of this study suggest that the net USD 15-year IRR of the observed DFI African private equity fund portfolios is, on a non-weighted average basis, flat. Returns associated with individual DFIs do show some level of dispersion around this average, albeit within a relatively narrow range. Reported pooled IRR performance numbers can in addition vary depending on calculation methodology and vintage bias, and this should be viewed as purely indicative.

It is worth noting that there have been public reports of diminishing returns over the past five years. Norfund has, for example reported no positive yearly IRR for its Scalable Enterprises Funds portfolio since 2014 (84% of Norfund's Scalable Enterprises commitments were in sub-Saharan Africa as of 2019)[8] and CDC described a difficult environment for its African private equity funds in its latest annual report, in which its funds operating segment reported an 8% loss.

As is discussed further in this section, individual private equity fund returns display significant levels of dispersion, across funds, managers and vintage years, and these aggregate measures should not obfuscate the existence of successful funds. The identification of the 'top quartile' funds is an integral part of the private equity investment process.

The most relevant performance data is that of fully realised funds, given the challenges of calculating accurate interim NAVs and the complexities linked to the cash calls and distributions cycle. Table 1 includes performance data pertaining to a selection of Africa-focussed private equity funds invested in by DFIs that have been fully realised, or very nearly fully realised. These examples should not be read as a statistically representative sample, but as illustrative of the observed dispersion of returns. These entries have been anonymised and numbers have been rounded.

7 Source: Shell Foundation and Omidyar Network: Insights on SME Fund Performance, 2019
8 Source: Norfund: https://www.norfund.no/key-figures/

Africa Infrastructure Fund I	DFI LPs	AfDB, CDC, EIB, Finnfund, IFC, Norfund, Proparco, Swedfund
	Vintage	2000
	Fund Size	Circa USD 400m
	Description	Focussed on infrastructure investments across sub-Saharan Africa
	Net IRR	22.50%
East Africa SME Fund I	DFI LPs	CDC, EIB, FMO, IFC, Norfund
	Vintage	2003
	Fund Size	Circa USD 40m
	Description	Invests in private sector enterprises based in Kenya, Tanzania and Uganda, concentrated on providing risk capital for expansion of profitable businesses
	Net IRR	5.50%
Southern Africa SME Fund I	DFI LPs	CDC, EIB, Norfund
	Vintage	2003
	Fund Size	Circa USD 50m
	Description	SME growth fund investing in sub-Saharan Africa
	Net IRR	4.00%
East Africa SME Fund I	DFI LPs	BIO, CDC, FinnFund, FMO
	Vintage	2006
	Fund Size	Circa USD 25m
	Description	Invests in small and medium enterprise (SME) business development and finance needs in Kenya, Tanzania, Rwanda and Uganda
	Net IRR	-3.50%
Africa Energy Fund I	DFI LPs	AfDB, FinnFund, IFC, Norfund
	Vintage	2008
	Fund Size	Circa USD 90m
	Description	Targets SMEs in the energy and environmental technology sectors
	Net IIR	14.00%
Africa Growth Fund II	DFI LPs	AfDB, CDC, EIB, FinnFund, IFC
	Vintage	2009
	Fund Size	Circa EUR 140m
	Description	Focussed on growth and expansion SMEs in North and sub-Saharan Africa
	Net IRR	8.50%

Table 1: Private Equity – Sample Fund performance

Private Equity Funds and Exit-Mobilisation

All available historical performance data pertaining to African private equity funds suggest that on average they have missed their USD IRR performance objectives, which are routinely set in the mid to high teens. Whilst currency devaluation has often been cited as a root cause of past underperformance, it will not likely be dismissed by prospective investors. Engagement with investors has over time consistently confirmed that portfolios comprised of such funds would not be expected to meet their return requirements and that an allocation was only possible where impact investing mandates existed, allowing for lower returns.

This does not however tell the full story. As is evident from the selected fund information presented above there are examples of funds that have delivered strong returns. Unfortunately, a pervasive lack of data and returns transparency across the African private equity landscape means that this encouraging reality is too often lost amidst the general recognition that the sector in aggregate is a poor performer. As a result, even those funds that outperform and could otherwise be expected to entice global institutional investors are still relying on DFI-heavy LP rosters.

This situation offers a clear opportunity for the MOBILIST programme. In the first instance, public markets solutions could be found for the best performing funds, where exit-mobilisation might occur through direct listing or secondary sales to listed vehicles. Secondly, a broader approach to fostering a more open and integrated private equity market could be pursued. Such an approach might, for example, attempt to facilitate greater data transparency and foster secondary liquidity. If successful these efforts could promote a market that is more efficient at supporting high performing GPs and better integrated with private investors.

2. ZOOM-IN ON EAST AFRICA

2.1. DFI ASSETS

2.1.1. Big Picture

Defining the Space

Somewhat counter-intuitively, there does not appear to be a universally accepted definition for East Africa. For the purpose of this study, it was therefore decided to focus on the East African Community (EAC) members, namely Kenya, Uganda, Tanzania, Rwanda, Burundi, and South Sudan, adding Ethiopia to ensure that the growing flow of investments made there until the current conflict broke out was also captured.

DFI Direct Commitments, 2010-2019

The direct equity and direct lending commitments made by DFIs to the East African region as captured in the database from 2010 to 2019 add up to USD 7.81 billion. The direct equity component accounts for USD 761 million while the direct lending accounts for USD 7.05 billion.

The breakdown by sector reveals a familiar picture with 41% of these investments made into the financial sector, and 42% into the infrastructure space.

The Forest and the Trees

For the purpose of exit-mobilisation it is important to identify pockets of concentration that can form the basis for sizeable transactions, and relatively high-quality assets more likely to prove attractive, particularly to 'first time' private investors. A key learning drawn from the mapping exercise is that DFI investments are to a significant extent aligned to both these criteria.

The analysis of commitments over time allows for the identification of the main recipients of DFI investments in specific sectors and geographies over time.

Combining this data with reporting from investee businesses or additional information on individual projects enables the painting of a granular picture of current DFI deployments into these companies and projects.

The following case studies, accounting for over USD 3 billion of current DFI funding, shine a spotlight on DFI investments in local financial institutions and large-scale infrastructure projects. They provide both direct evidence of the availability of concentrated deployments of such funding into relatively high-quality assets and a concrete basis for engagement with private investors.

2.1.2. 2 Billion Dollars in the Banks

Blue Chips and Development Finance

In the context of the mobilisation of private capital, a common concern is that development finance investments are often made into businesses and projects that are either too small or too risky, or both.

The analysis of the capital deployed by DFIs across East Africa does however suggest that a significant allocation is on the contrary made to contextually large, regulated, stock exchange listed financial institutions. Credit rating agencies (CRAs) provide an assessment of the risk associated with these banks, and many of them are rated in line with the sovereign debt issued by their governments.

As of the end of 2019, DFIs held aggregated equity investments and loans of over USD 2 billion with eight of the largest banks in the region. Where equity holdings are concerned, they are held pari-passu with local investors and in some cases with developed countries financial and strategic investors.

Listed domestic banks with market cap in excess of USD 100 Million – DFI capital exposure as of 31/12/19
(NB Arise B.V. is categorised as a DFI vehicle)

Name	Main Listing	DFI Equity %	DFI Debt %
Diamond Trust Bank PLC	NSE	0.00%	100.00%
The Co-operative Bank of Kenya Ltd	NSE	0.00%	100.00%
KCB Group PLC	NSE	0.00%	98.07%
Equity Group Holdings	NSE	11.99%	94.66%
CRDB Bank	DSE	23.50%	89.83%
BK Group	RSE	0.00%	83.00%
DFCU Ltd	USE	68.67%	79.76%
I&M Holdings PLC	NSE	10.13%	71.97%
NCBA PLC	NSE	0.00%	68.12%
NMB Bank	DSE	34.90%	57.07%

Table 2: Eastern African Community Listed domestic banks

On the debt side, DFIs provide the overwhelming majority of the long-term debt capital utilised by large listed East African banks, in some cases the totality. The only exceptions to this prevalence of DFI debt are the local subsidiaries of South African (ABSA and Stanbic/Standard Bank) Indian (Bank of Baroda) banks, and that of Standard Chartered, although even there DEG extended a 10-year, USD 20 million subordinated loan to Stanbic in 2019 attracting a 6.82% interest rate.

Whilst the pricing of these loans may be comparatively attractive for local banks, the successful issuance of debt instruments on local markets on the part of a few of them does suggest there is latent demand among local private investors.

One bank, USD 600 million: Equity Holdings Group PLC

Equity Holdings Group PLC commands the second largest market capitalisation on the Nairobi Securities Exchange (KES 137.93 billion, circa USD 1.26 billion), and at the end of 2019 had assets in excess of KES 673.68 billion (circa USD 6.15 billion). Beyond Equity Bank in Kenya, it operates subsidiaries in Uganda, Tanzania, Rwanda, South Sudan, and the Democratic Republic of Congo. Its shares are dual listed on the Ugandan Stock Exchange.

The bank attracts a B2 global rating from Moody's, in line with Kenya's sovereign debt, and an AA- long term rating from the specialist CRA Global Credit Ratings (GCR).

Its capital link to development finance begins at the shareholders' equity level. Arise B.V., the vehicle co-owned by Norfund, FMO and Rabobank, owns 11.99% of the Equity Holding Group, a stake currently worth over USD 165 million. This makes Arise the bank's largest shareholder by some margin. Britam, 26% of whose own equity is held by DFIs, is the bank's next largest institutional shareholder. The role of development finance capital is even more significant where the bank's long-term debt capital and access to funding is concerned.

As of 31 December 2019, the group's Kenyan operation had outstanding long-term debt totalling the equivalent of USD 417 million. 93.84% of this was provided by a group of DFIs, including the AfDB, the IFC, the EIB, and Germany's KfW and DEG.

It is interesting to note that the remaining 6.16% were contributed by Swiss specialist asset manager ResponsAbility, whose investors largely consist of private investors.

Lending Entity	Loan Outstanding	%	Currency	Maturity Date	Interest Rate
AfDB	10 723 000 000 KES	25.82%	USD	01/02/2023	LIBOR + 2.85%
IFC	7 049 000 000 KES	16.97%	USD	15/03/2023	LIBOR + 3.15%
IFC	10 354 000 000 KES	24.93%	USD	15/03/2026	LIBOR + 2.75%
KfW/DEG	10 408 000 000 KES	25.06%	USD	15/08/2026	LIBOR + 3.30%
ResponsAbility	2 559 000 000 KES	6.16%	USD	31/03/2021	LIBOR + 3.07%

Table 3: Equity Bank Kenya, long term USD debt

The pricing and maturity of the USD loans made to Equity Bank Kenya are illustrated above. It is again interesting to observe that ResponsAbility's loan, made on behalf of private investors, does not come at a significant premium to those extended by DFIs.

Elsewhere, the EIB provides 100% of the debt owed by the group's operations in Uganda and Rwanda, and 85% in the DRC. In total, Equity Group Holdings PLC is currently the recipient of over USD 600 million of development finance capital, in the form of equity and debt.

Tanzania: NMB Bank PLC and CRDB Group

Next comes NMB Bank PLC, the largest Tanzanian bank by market capitalisation on the Dar-es-Salaam Stock Exchange. NMB Bank PLC, formerly better known as the National Microfinance Bank had assets of USD 2.8 billion as of 31 December 2019.

Arise B.V. is once again the largest shareholder, this time holding 34.90% of the bank's shares, a stake worth USD 176 million at the time of writing. Tellingly from a private capital mobilisation standpoint, Arise shares the register with the SQM Frontier Africa Master Fund as well as Morgan Stanley's Frontier Market portfolio and Galaxy Fund.

NMB Bank PLC is a particularly interesting case study as it 'only' relies on development finance capital for 46.25% of its USD 116 million of senior debt. Apart from a loan from the Tanzanian Mortgage Refinancing Company, this is mostly the result of the issuance of several tranches of bonds and medium-term notes to both the local retail and the institutional markets. The potential for domestic capital mobilisation is in particular illustrated by third tranche of the retail programme issued in 2019, which was 233% oversubscribed. These are 3-year instruments, and the retail bonds pay a gross annual TZS coupon of 10%, while the corporate programme offers a 13.5% gross coupon.

NMB BANK PLC - SENIOR DEBT

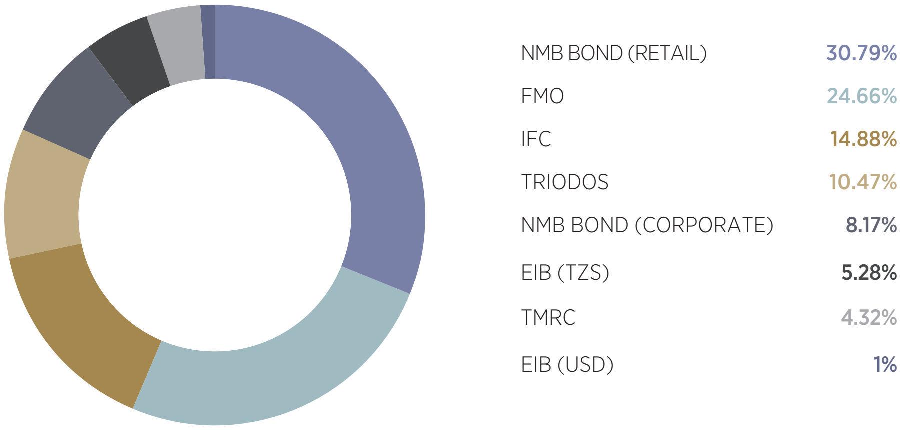


Figure 11: NMB Bank PLC – Senior Debt

Other loans to the bank provide comparison points. The 2019 effective interest rate on the basket of local currency loans provided by the EIB was 8.51%, while the 2018, TZS 28.3 billion loan from Triodos B.V. was arranged at a fixed effective interest rate of 14.4%. This is crucial information in the context of both domestic capital mobilisation and the assessment of relative pricing between international and local investors, as well as between public institutions and private impact investors. The entirety of the bank's outstanding subordinate debt is provided by the IFC.

Tanzania's second largest bank by DSE market capitalisation, CRDB Group is rated B2 by Moody's and 90% of its USD 128 million debt pile is provided by the AfDB and the EIB. It, in addition, has close links to DFIs on the equity side, as Danish DFI IFU holds 21% of its share capital, with CDC and IFC holding a combined and additional 2.50%.

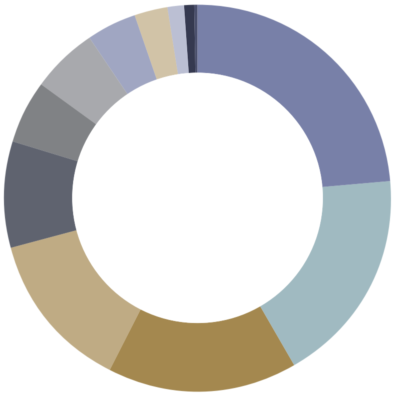
DFIs in Uganda: DFCU Limited

The history of Uganda's largest listed domestic bank is deeply intertwined with development finance. The Development Finance Company of Uganda was co-created by the Ugandan government's UDC and the United Kingdom's CDC in 1964. It subsequently crossed paths with the IFC and DEG, rebranded to DFCU and acquired Gold Trust Bank in 2000 and listed on the USE in 2004. Its market capitalisation is currently USD 126 million, and its assets were USD 798 million at the end of 2019.

It is currently majority owned by Arise B.V. whose holding accounts for 58.70% of the bank's shares, with IFU holding an additional 9.97%.

Given the specific nature of the institution, it comes as no surprise that 80% of its USD 73 million borrowings is provided by DFIs, the bulk of the remainder being with governmental entities.

DFCU LIMITED – DEBT



PROPARCO	23.65%
EIB – PEFF	18.05%
FMO	15.82%
DEG – SUB	13.41%
BANK OF UGANDA (ACF LOAN)	8.81%
EADB	5.44%
ABI-FINANCE	5.46%
UGANDA GOVERNMENT (KFW V LOAN)	4.35%
DEG – SENIOR	2.54%
JUBILEE INSURANCE	1.63%
EIB – MICROFINANCE	0.67%
UN HABITAT	0.17%

Figure 12: DFCU Debt

An Insurance Oddity: Britam Holdings PLC

Last but not least, Britam Holdings PLC is one of the most recognised names in the East African financial sector. Its market capitalisation is currently only about USD 160 million, but the shareholders' register makes for an interesting read.

The largest shareholder is a special purpose vehicle (SPV) managed by private equity general partner AfricInvest. The SPV holds 17.55% of the shares and is itself co-owned by FMO, Proparco and DEG, each with 21.82%, and the AfricInvest III fund, with 34.54%. AfricInvest III is in turn largely capitalised by DFIs including FMO (9.17%), DEG (4.40 %), PROPARCO (3.67%), CDC (10%), IFC, SIFEM, Finnfund, Swedfund and the AfDB. This multi-layered ownership structure involving a private equity fund buying listed shares, rather than listing a private stake, is rather unusual even in the development finance context.

The IFC holds 8.88% of Britam Holdings PLC's shares directly. In aggregate these stakes are currently worth around USD 50 million. Interestingly, Swiss Re in addition holds 15.79% of the group's equity.

2.1.3. Big Tickets and Syndicates: Infrastructure Deals in East Africa

Olkaria Geothermal Power stations: Olkaria III, PPA and USD 425 million of DFI Loans

Located just over 120 kilometres north-west of Nairobi, the Olkaria group of geothermal power stations are an essential component of Kenya's power supply. Olkaria I, II, III, IV and V are currently operational, with the addition of Olkaria VI scheduled for 2021. Nairobi Stock Exchange (NSE) listed Kengen owns and operates Olkaria I, II, IV and V, while American company Ormat Technologies Inc. owns and operates Olkaria III, somewhat confusingly through a Cayman Islands subsidiary called OrPower 4. Orpower 4 has entered a 20-year power purchase agreement (PPA) with KPLC.

All five, soon to be six, power stations have been funded through debt issued by development agencies and financial institutions. For the purpose of this example, the private sector led Olkaria III is the focus.

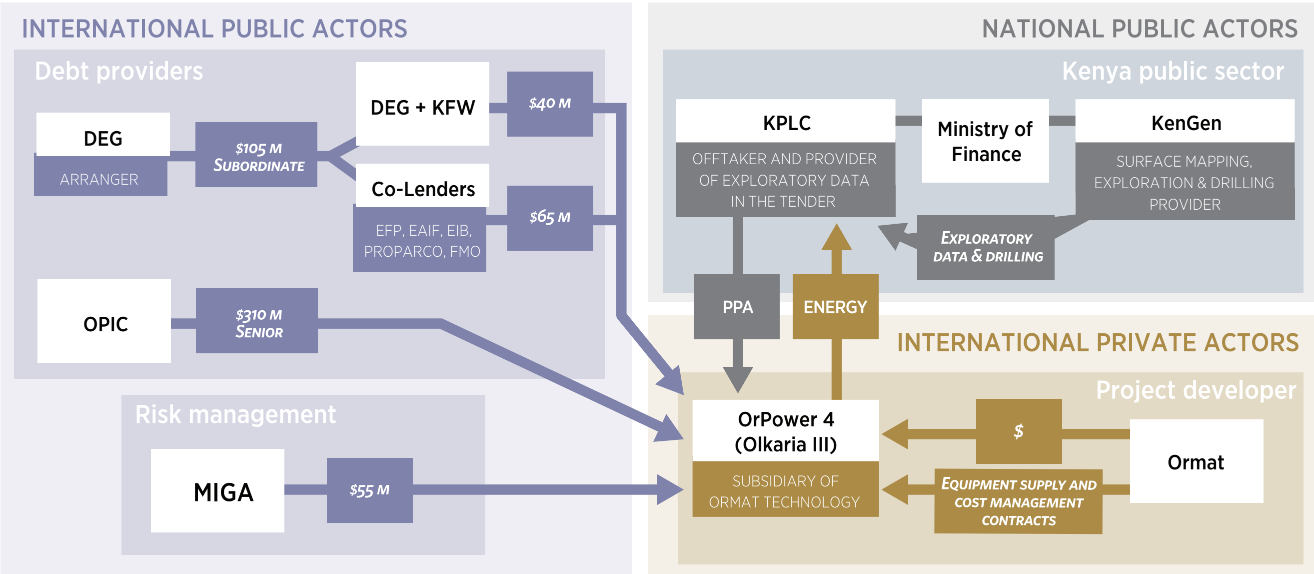


Figure 13: Olkaria III[9]

As shown above, DEG provided an initial 10-year, USD 105 million loan to refinance Phase 1 of the project. KfW/DEG accounted for USD 40 million while EAIF, FMO and Proparco and European Financing Partners/EIB contributed the balance. The loans were priced at 6-month LIBOR + 400 basis points, although Ormat elected to hedge USD 77 million at a fixed 6.9%.

The bulk of the debt came from OPIC in 2012 through a three-tranche, USD 310 million loan package, each tranche having a 19-year tenor. The first tranches of USD 85 million originally attracted a variable rate of interest, set at 2.94% for the first reset period. Both the first and the second USD 180 million tranche switched to a fixed rate in July 2013, while the third USD 45 million tranche disbursed in November 2013 was also drawn down at a fixed rate of 6.12%.

To complete the picture, MIGA issued political risk insurance to guarantee OrPower 4's equity investments against "the risks of transfer restriction, expropriation, war and civil disturbance for a 15-year tenor" (source: Climate Policy Initiative). The value of the coverage was adjusted throughout the project's history, starting in 2000 and reaching a high of USD 134 million in 2012.

Lake Turkana Wind Power Limited: 623 million Euros, 11 DFIs and Export Credit Agencies

The Northern Kenya Lake Turkana wind farm, at completion the largest on the continent, is an interesting case study in multi-layered deployment of DFI capital and of the use of export credit agencies (ECA) guarantees.

Nordic DFIs Norfund, Finnfund and IFU held about a third of the project's equity, while lead debt arranger AfDB, the EIB, FMO, Proparco and EDFI's ICCF to name but a few bore the brunt of the debt burden. The EUR 6 million loan from Dutch sustainable bank Triodos constitutes a small but noticeable contribution from the private sector.

9 Source: Climate Policy Initiative, Using Public Finance to Attract Private Investment in Geothermal: Olkaria III Case Study, Kenya

A key factor was the provision by the Danish export credit agency EFK of guarantees to the AfDB and the EIB. According to the 2017 OECD-led Research Collaborative on Tracking Private Climate Finance report[10], "EKF is involved through the provision of a project finance guarantee to EIB and AfDB, which covers up to 80% of the bank's loss equivalent to DKK 858 million (EUR 100 million) for EIB and DKK 172 million (EUR 20million) for AfDB".

This is an interesting factor as ECAs have historically enabled commercial banks – conspicuously absent in this instance – to lend to infrastructure projects.

The data compiled for this study complemented by a report published by the Institute of Development Studies[11], determines the project's blended cost of debt is 7.5% with 15-year maturity for senior debt and an aggregate debt average maturity of 12 years.

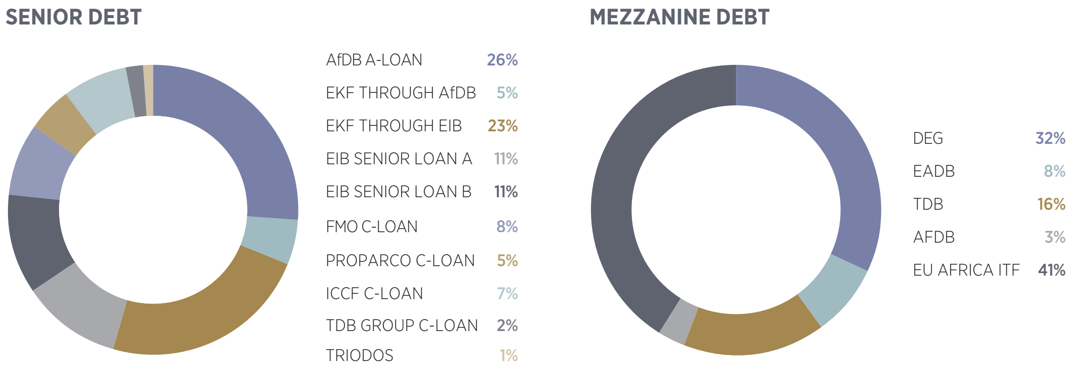


Figure 14: Lake Turkana Debt[12]

Another interesting feature of the Lake Turkana project's financing is its relative complexity. The avalanche of DFIs present at all levels of the capital stack could of course be explained by headroom and risk sharing considerations.

Klagge & Nweke-Eze (2020)[13] do however suggest there might be an altogether less technical motivation, and that DFIs "pursue their own institutional interests and, according to our interview partners, not only collaborate in the development of large-scale renewable-energy projects but also compete for participation, for the sake of 'pitching their flags' in 'worthy' projects (AfDB, EIB, KfW, TDB interviews 2019)."

In either scenario, there does seem to be a case for private capital mobilisation, either at the primary stage to address headroom limitations or tackle large projects, or at the secondary stage to recycle scarce DFI capital once the flag has been pitched.

Umeme Limited

Umeme, which distributes 97% of Uganda's electricity and trades on both the USE and the NSE, presents an atypical but interesting study of DFI participation in local infrastructure assets.

Umeme went public in 2005, providing Actis, itself the result of a 2004 management buy-out of CDC's ownership, with an exit. Its IPO was 35% oversubscribed, mostly by local institutional and retail investors, although the IFC also participated and to this day retains a 2.78% stake, surrounded by African listed equity fund managers ranging from Allan Gray to Investec, and the London Stock Exchange (LSE) listed Utilico Emerging Markets investment trust.

The IFC in addition provides Umeme with a term facility the terms of which were redefined in 2019. The IFC contributes USD 38 million while Stanbic Bank and Standard Chartered Bank are committing USD 16 million each. All of these are priced at LIBOR + 5.00%. The lack of observable concessionary pricing would suggest that Umeme, a listed company, provides a useful example of the interchangeability of DFI and private capital funding on the basis of pricing, although all aspects would need to be more thoroughly assessed to draw precise conclusions.

10 Source: OECD: https://www.oecd.org/env/researchcollaborative/Tracking_Climate_Related_Export_Credits_FINAL.pdf
11 Cost and Returns of Renewable Energy in Sub-Saharan Africa: A Comparison of Kenya and Ghana, Ana Pueyo, Simon Bawakyillenuo and Helen Osiolo, IDS, April 2016
12 Source: Aldwych International, Seminar on Sustainable Energy Investments in Africa, Copenhagen, June 2014
13 Financing large-scale renewable-energy projects in Kenya: investor types, international connections, and financialization, Britta Klage & Chigozie Nweke-Eze, February 2020

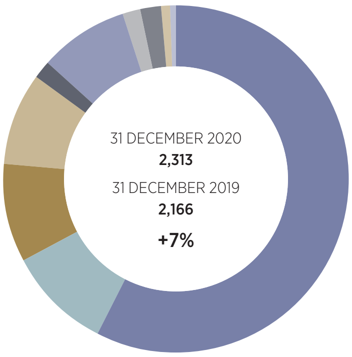
2.2. TDB GROUP, A REGIONAL DFI IN FOCUS[14]

The origins of the Eastern and Southern African Trade and Development Bank (TDB Group) can be traced back to 1985 with the establishment by Treaty of the PTA Bank, TDB's former name, by the member states of the Common Market for Eastern and Southern Africa (COMESA). With principal offices in Mauritius and Burundi, and an operational hub in Kenya, the bank now serves 22 member states. TDB's assets have grown 7-fold in the past decade to USD 7.2 billion in 2020, far more than those managed by other regional DFIs, even those with a much longer history[15].

The bank's gross loan portfolio now stands at USD 5.8 billion, close to 60% of which is categorised as trade finance, with the balance disbursed to project and infrastructure finance. Trade Finance, TDB's short-term lending window, provides innovative working capital and trade-related solutions across various products with tenors of up to 3 years. Project and infrastructure finance is TDB's medium to long term lending window. It extends financing to various high impact sectors, with tenors of now up to 20 years. It is worth noting that about 60% of the TDB Group's commitments are "made directly to sovereigns and public enterprises", and therefore do not squarely fall within the scope of this study.

True to its roots, TDB's balance sheet is largely geared towards trade finance and infrastructure projects. Most of TDB's portfolio is geared towards contributing to the SDGs, with a particular focus on addressing climate mitigation and adaptation imperatives.

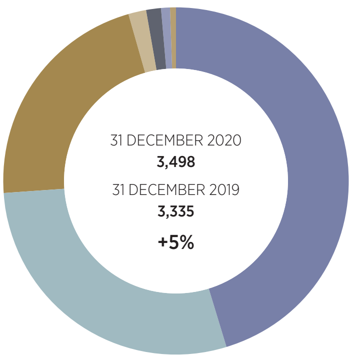
PROJECT FINANCE



		EXPOSURE AMOUNT
INFRASTRUCTURE	22.4%	1,299
MANUFACTURING	3.8%	233
TRANSPORT	3.6%	208
ENERGY	3.4%	199
ICT	3.2%	185
AGRI-BUSINESS	1.4%	81
BANKING AND FINANCIAL SERVICES	0.7%	42
HOSPITALITY	0.7%	42
HEALTH SERVICES	0.3%	20
REAL ESTATE	0.2%	14

Figure 15: Loan Portfolio Gross Exposure by sector, 31st December 2020

TRADE FINANCE



		EXPOSURE AMOUNT
OIL & GAS	27.3%	1,587
AGRI-BUSINESS	17.3%	1,003
BANKING AND FINANCIAL SERVICES	13.0%	755
ENERGY	1.0%	59
OTHER	0.8%	46
WHOLESALE COMMODITY TRADERS	0.5%	30
CONSTRUCTION	0.3%	17

Figure 16: Loan Portfolio Gross Exposure by sector, 31st December 2020

14 Source: TDB Group
15 For example, The East African Development Bank (EADB), created in 1967 in Uganda to support the East African Community market, reported total assets of USD 375M in 2019.

2.2.1. An early mover on private capital mobilisation

Recognising a need to consolidate and diversify both its shareholding and funding base, TDB has been engaging early-on with private capital. A landmark success has been the creation of Class B shares authorised by its Charter in 2013 to accommodate the specific needs of institutional investors – a rare occurrence in the world of DFIs.

The share of institutional investors has subsequently grown from 6% in 2010 to reach over a quarter of current paid-in capital. Eighteen institutional investors currently hold Class B shares. Whilst these do include international DFIs, including Denmark's IFU and the AfDB, TDB was perhaps more interestingly able to attract equity investments from more than a dozen regional insurance companies and pension funds, including Uganda's NSSF.

In addition to solid financial performance (23% net profit 10-year CAGR, ROEs consistently between 10% and 12%, investment grade Baa3 rating by Moody's, IFRS9 compliance), this success is the result of a keen focus on governance.

2.2.2. The potential to set an innovative precedent for DFIs

In September 2020, alongside a record capital increase programme of USD 1.5 billion and the doubling of the current authorised capital stock of the bank from USD 3 billion to USD 6 billion, TDB shareholders authorised the issuance of up to USD 1 billion of a new Class C share segment "in view of attracting, further, non-traditional pools of impact and other types of investors".

TDB is currently exploring new instruments including equity capital products aimed at creating innovative pathways for global institutional and impact investors to realise commercial returns while catalysing climate action and SDG impact in the region served by the bank. In this context, the bank is assessing the possibility to have future Class C shareholders benefit from dedicated reporting and safeguards to ensure equity is only used to back sustainable finance projects which directly respond to climate mitigation and adaptation imperatives.

It is envisaged that this new equity would then be leveraged to further widen the pool of green debt capital from global funding partners already being intermediated by TDB for on-lending to finance sustainable infrastructure and climate action in TDB's 22 member states.

2.3. THE REGULATORY FRAMEWORK

2.3.1. Of the Importance of Financial Regulation

"A thriving, dynamic financial services sector is vital to the success of any modern economy. Financial markets, banks, insurance companies, investment firms and a wide range of other financial institutions are an essential part of a nation's economic infrastructure. They play a crucial role in transforming savings into productive investment and provide the means for efficient management of risk."
HM Treasury, Financial Services Future Regulatory Framework Review, 2019

The excerpt above was taken from a recent review of the UK's regulatory framework for financial services by HM Treasury, to provide a useful reminder of the importance of financial markets and by extension the regulation thereof. This is pertinent in the context of MOBILIST and East African markets, where the inherent qualities of each local regulatory framework may prove relevant in assessing the potential for a near-term contribution to the initiative.

Local regulatory frameworks should be assessed for their capacity to foster national savings on one hand, and to provide efficient access to global capital flows on the other.

2.3.2.A Complex Alchemy: Multi-Factor Comparative Analysis

A multi-factor grid, showing in Table 4 below was employed to identify the key defining properties of each local market's regulatory framework, and to allow for a subsequent comparative analysis. The research focused on four of the region's markets: Kenya, Uganda, Tanzania, and Ethiopia.

	Kenya	Uganda	Tanzania	Ethiopia
Principal regulatory legislation	Central Bank of Kenya Act (2015), Banking Act (2015), Microfinance Act (2006) National Payment System Act (2011), Kenya Deposit Insurance Act (2012), Retirement Benefits Act (1997 & 2017)	Uganda Securities Exchange Limited Rules (2003) Bank of Uganda Acts (1969 & 2000), Financial Institutions Act (2004)	Banking and Financial Institutions Act (2006), Bank of Tanzania Act (2006)	NBE Establishment Proclamation (1963), Banking Business Proclamation (2008)
Principal listing rules	Capital Markets Regulations (2002), Nairobi Securities Exchange Listing Rules (2014)	USE Listing Rules (2003)	Dar Es Salaam Stock Exchange Rules (DES 2014)	Under discussion – Various local bills voted in 2020 aiming at the creation of a Stock Exchange & listing rules
Financial services regulator	Central Bank of Kenya, Capital Markets Authority	Bank of Uganda, Capital Markets Authority of Uganda	Capital Markets and Security Authority, Bank of Tanzania (BOT), Social Security Regulatory Authority	National Bank of Ethiopia, Ethiopian Investment Board, Ethiopian Investment Commission
Stock exchange	Nairobi Securities Exchange (NSE)	Uganda Securities Exchange (USE)	Dar es Salaam Stock Exchange (DSE)	N/A
ISDA netting	N/A	N/A	N/A	N/A
Foreign investment restrictions	Restrictions apply for the banking, insurance, mining, and telecommunications sectors. Caps on financials if non-EAC/non CBK licensed: 67% for Insurance, 25% otherwise.	Foreign ownership over 50% are subject to some limitations, and specific taxes. Investments in the Banking Sector are subject to a specific license.	Foreign investor participation in government securities is subject to conditions.	Private investment prohibited in most sectors. Liberalization currently under review pending the creation of a Stock Exchange
Disclosure rules	Issuer must disclose every shareholders over 3% and name the 10 largest shareholders in their annual report	Issuer must disclose all shareholders over 3%		
Currency controls	N/A	N/A	All transactions must be registered with the BOT.	Foreign currency transactions must be approved by the National Bank of Ethiopia.

Table 4: EAC Countries Financial Regulatory Framework: Kenya, Uganda, Tanzania, and Ethiopia[16]

16 Sources: Clifford Chance: Africa Financial Regulation Oct. 2019, The World Bank Group: Pension Systems in Africa 2019; Eighteen East: investor interviews, December 2020/January 2021

Item	Categories of Assets	Max % of aggregate market value of total assets of scheme or pooled fund
1	Cash and Demand Deposits.	5%
2	Fixed Deposits.	30%
3	Listed Corporate Bonds, Mortgage Bonds and Fixed Income Instruments.	20%
4	Commercial Paper.	10%
5	EAC Government Securities and infrastructure bonds.	90% or 100%
6	Preference shares and ordinary shares of companies listed in a securities exchange in the EAC and collective investment schemes incorporated in Kenya.	70%
7	Unlisted shares and equity instruments of companies incorporated in Kenya and collective investment schemes incorporated in Kenya.	5%
8	Offshore investments in bank deposits, government securities, listed equities and rated Corporate Bonds and offshore collective investment schemes.	15%
9	Immovable property in Kenya.	30%
10	Guaranteed Funds.	100%
11	Exchange traded derivatives contracts.	5%
12	All listed Real Estate Investment Trusts incorporated in Kenya.	30%
13	Private Equity & Venture Capital.	10%
14	Any other assets.	10%

Table 5: Kenyan Pension Funds: RBA Regulations and Policies[17]

2.3.3. Keep it Simple

East Africa's local market infrastructure is relatively mature and largely adequate for the purposes of exit-mobilisation. This is especially true of Kenya, as the region's most important market, but applies across the board. New product launches are difficult in any circumstances, but history suggests that they are especially difficult in East Africa where, as per the investor feedback gathered for this report, sponsors must navigate a conservative and fragmented landscape, as well as demanding local investment guidelines (see Table 5). It is therefore contended that exit-mobilisation efforts should both learn from the recent successes of apposite products and be designed according to existing regulatory frameworks and attitudes to risk.

For illustrative purposes, a selection of relevant precedents is listed below:

Listed Investment Trusts

- Closed-End Funds structures have been authorised for listing on the NSE for several years. They have yet to fulfil their potential and there is only one currently listed on the NSE. New initiatives are however in the pipeline, two of which are currently being developed by Acorn.
- The StanLib Fahari i-REIT is the only investment trust currently listed on the NSE. It was launched in 2015 by StanLib, SBG Securities and The Co-operative Bank of Kenya as sponsors and trustee, and has attracted a balanced mix of investors, local and foreign, individual, and institutional. It however remains very thinly traded to this date with average daily turnover below USD 1 000.

Acorn Green Bond

- The KES 4.3 billion (USD 40 million) issue in 2019 by Acorn Holdings was Kenya's inaugural green bond, and at the time the 17th to close in Africa. The bonds are dual listed on the NSE and the LSE.
- The Acorn Green Bond is supported by a GuarantCo guarantee and a cornerstone investment from EAIF and was structured with the support of FSD Africa.
- This is an important example of the potential for further collaboration between the UK and Kenya towards developing local capital markets and attracting investment into Kenya.

17 Source: The Retirement Benefits Authority (of Kenya), 2021

Centum Investment Company – Equity Linked Bonds

The Centum Investment Company was founded in 1954 as ICDC and listed on the NSE in 1967. In 1998, the Government of Kenya reduced its majority shareholding and installed independent management and governance. In 2007 shareholders changed the name of the company to Centum.

Centum is structured as an investment company listed on the NSE and cross-listed on the Uganda Securities Exchange, with a USD 103 million market capitalisation.

It holds interests in private equity, quoted equity, and real estate investments in East Africa, as well as investments in listed securities across sub-Saharan Africa. Its listed structure offers investors access to an otherwise illiquid and inaccessible portfolio of assets.

Centum's free float stands at 85%, with the majority of shares being held by local investors. The NAV has grown significantly over the past decade, growing from KES 4 billion in 2009 to KES 47 billion by 2020. This equates to NAV per share having grown by a CAGR of 18% since 2014.

Centum is also active in the local debt capital markets and in 2020 announced a KES 4 billion 3-year zero coupon note to fund residential development projects. Two key features are the zero-coupon medium term note structure, and an optional redemption into equities. Both are standard features for exchange traded products across global markets. GCR has affirmed Centum Investment Company PLC's long-term issuer credit rating at A+(KE) and short-term issuer rating at A1(KE).

NEXT Derivatives Market

- The launch in 2019 of the Next derivatives market by the NSE constitutes a milestone for East African financial markets, further proof of local markets sophistication, and very relevant in the context of MOBILIST. Listed Derivatives markets pre-suppose a complex eco-system supported by dedicated regulations, IT systems and a variety of market participants, from executing brokers, clearing, transfer and payment agents, to margin and collateral management, not to mention customer accreditation and trading systems.
- It is to be noted the current derivatives contracts are limited to Futures contracts on the NSE25 Stock Index as well as a few listed equities, and that trading volumes remain mostly anecdotal. Still by its very existence the Next derivatives market provides the tools to assist with product development, notably synthetic securitisation efforts, as well as more generally with the hedging of existing stakes in the context of secondaries offerings or even new listings and IPOs.

3. INVESTOR ENGAGEMENT

3.1. EAST AFRICAN INSTITUTIONAL INVESTORS

3.1.1. Overview

Within the EAC, Kenya has, by some margin, the most developed and diversified institutional investors landscape. Pension funds are the custodians of the bulk of institutional assets, with assets under management of KES 1,17 trillion in December 2018, equivalent to roughly USD 11 billion[18].

The most striking characteristic of the sector is a highly conservative approach.

The quarterly Zamara Consulting Actuaries Schemes survey provides insights into the asset allocations of a subset of the sector accounting for KES 901 billion of assets. The average allocation to fixed income stood at 74.7% at the end of June 2020, and the average allocation to equity at 19.9%. The balance was contributed by allocations to property (5.7%) and offshore assets (0.7%). It is however worth noting that only 21.8% of participating schemes had an allocation to property and only 24.6% of schemes had any exposure at all to offshore assets.

The surprisingly low allocations to domestic equity markets can be explained by a very narrow and shallow equity market, dominated by Safaricom and by the poor performance of the Kenyan equity market over the last five years. Kenyan pension funds in addition live in the memory of losses incurred on offshore markets, keeping their allocation to a level far below what is authorised by the regulator.

3.1.2. Kenyan Investor Outreach

Interviews were conducted with Kenyan investment firms with an aggregate USD 2.45 billion in assets under management, managing 65 pension schemes, including mandates from Safaricom and the NSSF.

The story they tell is one of significant risk aversion across asset classes, driving institutional assets towards sovereign bonds.

On the equity front, a five-year bear market accentuated by the exodus of foreign portfolio investments has caused trustees to shy away from equity risk. There have been no recent IPOs, which in turn prevents investors from diversifying their exposure in a market where Safaricom, with a market capitalisation of KES 1.4 trillion accounts for almost 60% of the aggregate market capitalisation of equity listings on the NSE.

18 Source: RBA, Retirement Benefits Industry Report, Dec 2018

KENYAN PENSION FUNDS AVERAGE ASSET ALLOCATION – 30 JUNE 2020

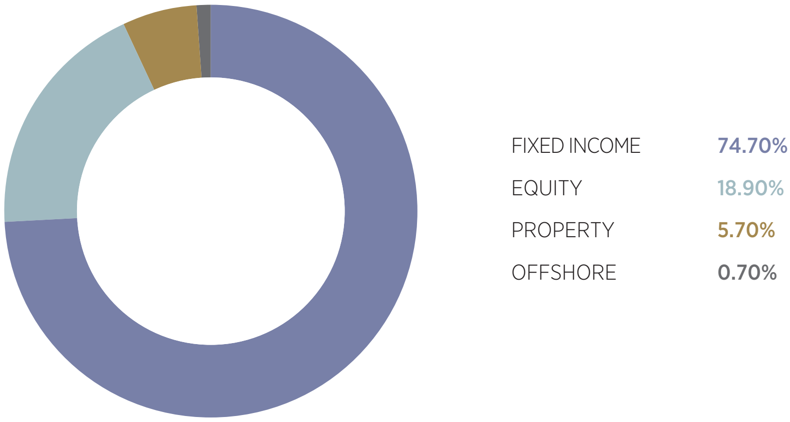


Figure 17: Kenya pension funds allocations[19]

Asset managers have been engaging with the Kenyan government to encourage the privatisation and subsequent listing of state-owned companies to create opportunities for diversification, thus far to no avail.

Respondents in addition indicated that they considered the Capital Markets Authority (CMA) listing requirements to be too stringent, and a corresponding lack of incentives to be a barrier to IPOs. The tax situation was also identified as a significant hurdle. The CMA does not offer 'tax holidays' to companies as they go public, which is seen as a strong inhibitor, particularly in a context where private companies are often suspected of drawing up distinct set of accounts for tax purposes. Going public and therefore transparent would, in such cases, come at a high cost.

The picture is split when it comes to potential investor appetite with DFI holdings in listed stocks. Some respondents indicated interest would be limited given the fact that all large stocks are already held by all large schemes, but others considered it could be attractive given depressed valuations, and that an additional benefit would be the potential to improve liquidity by unlocking these long-term strategic stakes.

On the listed investment vehicles front, the largest respondent indicated that should the Centum concept be replicated there would likely be appetite in the market given the diversified access it provides to private assets, and the fact that whilst its share price has suffered from the bear market, the NAV performance has been satisfactory.

Real estate investment trusts (REITs) are also an area of interest, with a number of them currently looking to list, including one managed by Acorn focussed on student housing, and one focussed on mortgages.

Issuance on the corporate bond market in Kenya has all but collapsed over the last two-years further to high profile defaults from two banks (Chase and Imperial). One respondent indicated its allocation to corporate debt remained at 15% but that further issuance would be necessary to maintain it.

A small number of recent issues do however provide grounds for optimism. East African Breweries Limited (EABL), controlled by Diageo, for example issued a 5-year, KES 6 billion, 14.17% fixed rate bond in March 2017. The issue was 41% oversubscribed. More recently, Centum raised a 3-year, KES 3 billion, 12.5% medium term zero-coupon note. Closer to the MOBILIST agenda is the Acorn bond issue described above.

19 Source: Zamara Consulting Actuaries Schemes Survey, June 2020

Respondents confirmed that there could be appetite for debt issues but qualified this opinion by highlighting a number of constraints:

- Given the fact that the bulk of the loans issued by DFIs are denominated in USD or EUR, it is important to note that there is very little appetite for hard currency assets amongst local institutional investors, which stands to reason given the marginal level of their hard currency liabilities. The bulk of the appetite for USD assets is according to interviewees linked to the private wealth sector. Those investors willing to consider USD assets would most likely find the yields on offer unattractive compared to local currency alternatives.
- Given the recent increase in risk aversion brought about by the above-mentioned defaults, only issues associated with 'blue chip' names, high levels of collateral or the provision of guarantees are likely to be deemed attractive. A credit rating would in addition be required.
- From a yield standpoint, given 5-year government bonds offer investors a 10% return, respondents indicated even such local currency issues would need to offer somewhere in the region of 14-15% to be attractive. Should a guarantee be available, a yield superior to 12% could be sufficient. Interestingly one respondent indicated that a 12% issue with some form of guarantee would be more attractive than a high credit quality 15% issue.

Where the underlying sector is concerned, respondents indicated that both financials and infrastructure would be of interest to investors. Financials linked issues would benefit from the good knowledge of the sector on the part of investors, their regulated status and – recent hiccups notwithstanding – the strong historical performance of Kenyan banks.

On the infrastructure side, appetite amongst institutional investors is evidenced by initiatives such as the Kenya Pension Funds Investment Consortium (KEPFIC), whose raison d'être is to "mobilise institutional capital for impactful infrastructure and alternative asset investments".

One respondent indicated that the power purchase agreements (PPAs) underlying many infrastructure projects are deemed to be designed to favour investors, and there is therefore appetite to participate. It is also worth noting that Kengen, who in 2019 repaid its 10-year, KES 25 billion, 12.5% infrastructure bond thereby setting a reassuring precedent, was at the time considering issuing green bonds as well as asset backed securities.

Kenya Pension Funds Investment Consortium (KEPFIC)

KEPFIC was formed by five of Kenya's largest pension funds, with support from the World Bank and USAID, to facilitate infrastructure investments and provide much needed avenues for diversification away from fixed income allocations dominated by government bonds and listed equity exposure within which Safaricom dwarves all other counters. Locally funded infrastructure investment has to date been the almost exclusive domain of the government, which is now under increasing fiscal pressure. Further to the Retirements Benefits Authority's (RBA) introduction of a 10% authorised allocation to infrastructure investments, the US ambassador to Kenya estimated this could unlock KES 100 billion of pension fund monies.

KEPFIC's mandate is focussed on sourcing and screening investment opportunities and conducting a first layer of due diligence. Deals will then be put forward for consideration by individual pension fund managers.

Given the conservative stance of its members, KEPFIC will in a first instance look for lower risk opportunities, with a focus on debt and brown field projects. It has a natural preference for local currency exposure, but KEPFIC understands that the current landscape for infrastructure finance in the region is dominated by DFIs, which will mean hard currency deals might well prove a necessity, particularly given its members will not be in a position to lead transactions. Further down the line, construction risk could be introduced while maintaining a debt focus, and eventually equity stakes will be considered.

There is however a will to grow a local currency debt market, and smaller deals will be considered. Discussions have in addition been held with banking institutions to establish the ability to hedge currency exposure back to local currency. A potential secondary investment in a Euro loan to an HFO powerplant could for example be swapped back to KES. There are also instances of deals with a small local currency component, such as a French consortium led road PPP deal which included a USD 50 million local currency tranche.

KEPFIC indicated the ability to offer its members exposure to an existing portfolio of infrastructure loans, ideally with 5 to 10-year tenor, and an aggregate deal size of USD 10-50 million would be attractive. This would in particular allow them to involve smaller members who would otherwise struggle to meet minimum ticket size requirements and lack the due diligence capacity of industry relevant schemes such as those of Kenyan Power and Kengen.

KEPFIC is a clear-cut illustration of the relevance of the exit-mobilisation agenda in the African infrastructure space. Local investors seeking to gain exposure to infrastructure investments long the preserve of DFIs can be a shorter route to mobilisation than their OECD countries counterparts.

3.1.3. Uganda's Institutional Investor: the NSSF

According to URBRA's quarterly investment snapshot published in September 2020, the Ugandan NSSF's internal management accounted for 86% of surveyed pension assets. This high level of concentration is by no means an isolated case in the African context, but it does mean that exit-mobilisation effectively has a target audience of one in Uganda. The NSSF reported total assets of just over 13 trillion Ugandan shillings as of the end of June 2020, equivalent to roughly USD 3.5 billion. Its asset allocation by now paints a familiar picture, with fixed income accounting for 77.25% of its portfolio, followed by equity (15.06%) and real estate (7.69%). A closer look once again shows a concerning lack of diversification. Treasury bonds represent 99.4% of its fixed income portfolio, and the concentration of its equity allocation is illustrated below.

This puts the scheme in a position of vulnerability it publicly acknowledges. The NSSF's managing director indicated that the fund is limited to investments in the East African region and to the instruments allowed by its regulatory regime. The fund has however stated it is actively looking for opportunities to diversify and could be a key partner for local capital markets-based exit-mobilisation. Further grounds for optimism stem from its acquisition of a direct equity stake in regional DFI TDB Group (formerly known as PTA Bank).

NSSF INTERNAL EQUITY PORTFOLIO – 30 JUNE 2020

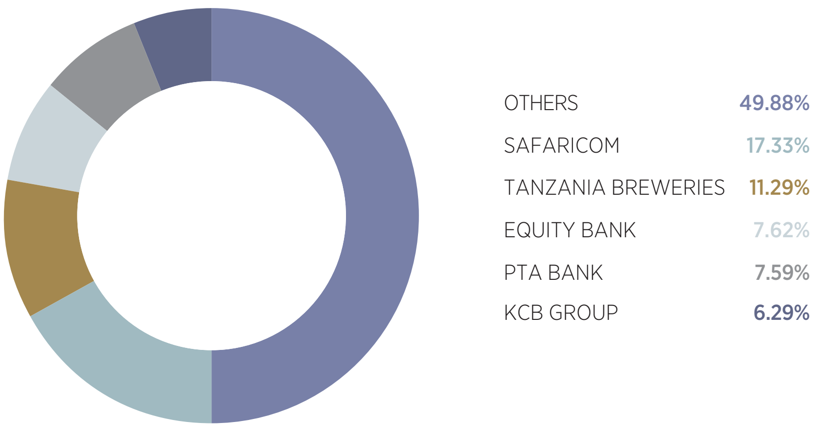


Figure 18: NSSF Equity Portfolio (source: NSSF)

3.2. A SOUTH AFRICAN GIANT: THE PIC

3.2.1. Overview

With assets under management in excess of USD 125 billion as of March 2020, the PIC stands out in the African institutional investor landscape if only by virtue of its size. But it is also differentiated by the nature of the mandates it holds, for example from its largest client (85.92% of AUM), South Africa's Government Employees Pension Fund (GEPF). The PIC is as a result not only more present in what it refers to as the 'rest of Africa' than its OECD countries counterparts, or indeed its fellow South African schemes, but also has a social impact focus seldom observed in the pension industry. It aims to be "a global leader in impactful investing" and has been at the forefront of impact investing in the South African context. These two characteristics have in turn meant that it has routinely been a co-investor, sometimes the lead, in funds and investments supported by DFIs.

3.2.2.The PIC and DFIs

Private Equity

Unlike DFIs, the PIC's private equity programme is strongly focussed on direct investments rather than on intermediated fund investments. It has however invested alongside DFIs in a number of private equity funds, both in South Africa and in the rest of Africa. It is also worth noting that it sources its direct investment opportunities through the use of internal resources and therefore has a lesser reliance on co-investment opportunities than DFIs. Another important distinction is that it keeps these two geographies separated and can therefore only invest in pan-African funds if they exclude South Africa, or if they themselves can be excluded from South African investments.

The PIC has for example made investments in 'DFI-heavy' funds like the Abraaj African Opportunity Funds III or the African Food Security Fund where its 2018 USD 20 million commitment on behalf of the GEPF made it the largest investor (27.1%) ahead of the AfDB (20.3%), CDC (20.3%), the Dutch Good Growth Fund (16.3%) and Denmark's IFU (8.1%). It does however profess to have a more selective approach when it comes to managers, which it does not systematically 'support' from one fund to the next, and to advocate a manager type diversification approach, rather than the mid-market focus observed in DFI portfolios.

The PIC's dual social and African mandate means it does invest pari passu with DFIs, and since it does not self-identify as a provider of concessionary capital, it suggests that, where the LP investment is concerned and through the lens of African institutional investors, DFI investments are not either. The provision of technical advisory facilities by DFIs does however constitute a clear differentiator and something the PIC cannot provide.

The PIC would consider buying DFI stakes through secondary transactions but, notwithstanding pricing considerations, it has to date not observed any meaningful appetite for such exit-mobilisation transactions, and the assumption is that DFIs wish to benefit from the full financial performance and therefore are reluctant sellers. Where it does have a more meaningful transactional relationship is through its direct investment programme, which is a frequent buyer of individual positions held by DFI-backed private equity funds. As a result, the PIC is a clear and potential buyer for direct equity exit-mobilisation.

Infrastructure

The PIC's long term investment horizon again enables it to invest alongside DFIs, according to the same terms, in infrastructure projects. Its overall preference for equity exposure is less relevant to projects where it is comfortable with taking a vertical slice of debt and equity. The PIC teams are however conscious of their unique status, and other South African pension funds do have a preference for debt and a documented aversion for construction risk. The conversations held highlighted potential appetite across the sector for a collective investment scheme, which could be listed on the Johannesburg Stock Exchange (JSE) (and potentially dual-listed on the LSE) offering investors with exposure to a secondary portfolio of DFI infrastructure loans 'five years in'. The PIC's participation in infrastructure funds in the rest of Africa is more anecdotal, but it is worth noting that it, for example, was the largest investor with the IFC in the Convergence Partners Communication Infrastructure Fund, a scheme to which DBSA, the EIB, CDC and FMO also contributed.

3.3. WESTERN AFRICA: NIGERIAN PENSION FUNDS

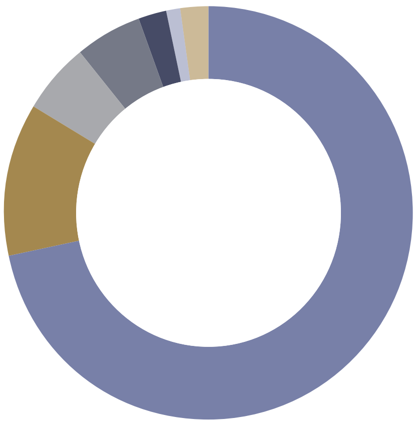
Whilst it is not within the scope of this report to provide a granular analysis of institutional investor assets in western Africa, an overview of the asset allocation of Nigerian pension funds is useful to support the observations made in the East African context.

According to The National Pension Commission (PenCon), Nigerian pension funds were in custody of NGN 10.22 trillion (USD 25.7 billion) as of the 31st of December 2019. Figure 19 illustrates a familiar paradigm. Government debt, federal and state, add up to 73.03% of all pension fund assets, with corporate debt and listed equity adding up to just under 11%. Here again foreign holdings amount to less than 1%, and private equity funds or infrastructure funds barely register, at 0.34% and 0.41% respectively.

Pencon's Regulation on Investment of Pension Funds Assets (February 2019) determines maximum asset allocations for pension funds according to life stages (I to IV) or special situations (V and VI). Maximum allocations to infrastructure and private equity funds range from 0 to 10%. Even for those funds allowed to allocate to these assets, the actual allocation is seldom above 1%.

The issue is therefore at this stage not linked to a regulatory barrier, but to be explained by either supply, demand, or a combination of both. The Nigerian pension industry's lack of diversification does however reinforce that rather than just an opportunity, there is a need for exit-mobilisation to give African investors a more comprehensive exposure to their own economic growth.

NIGERIAN PENSION FUNDS ASSET ALLOCATION – 31 DECEMBER 2019



FEDERAL GOVERNMENT SECURITIES	71.90%
MONEY MARKET	11.48%
DOMESTIC CORPORATE DEBT	5.55%
DOMESTIC LISTED EQUITY	5.41%
REAL ESTATE	2.25%
OTHER	2.00%
GOVERNMENT SECURITIES	1.41%

Figure 19: Nigerian pension funds allocations (source: PenCon)

3.4. UK INSTITUTIONAL INVESTORS

3.4.1. Overview

Interviews were conducted with UK-based institutional investors across a range of sub sectors considered most relevant to the agenda of mobilising new institutional capital into Africa. A qualitative interview, sample-based approach was adopted given the specificity of the subject matter and the practicalities of the data mining exercise associated with a quantitative approach. Although the nature of this capital is in the context of exit-mobilisation more relevant than its quantum, interviewed investors manage assets in excess of USD 1.5 trillion.

Overall, investing in Africa remains a niche activity in the UK, associated with an ad hoc rather than formally defined approach to allocations.

Some consistent themes were highlighted:

- Investment in African listed equity has historically been the most commonly held exposure, but over the last five years the performance of frontier and African equity markets has caused some investors to exit their positions.
- No overall restrictions to investing in Africa were cited, whether on a government regulatory basis or through any industry association restrictions.
- Investors expressed a slight preference for gaining exposure to African assets through private funds rather than through listed structures. This is mainly due to perceived constraints pertaining to vehicle size and liquidity. Investors would however be willing to consider listed structures addressing these concerns.
- Investors generally did not express a strong sector specific preference for potential future investments although they are most positively disposed towards infrastructure.

UK investors are not significantly represented among the membership of industry organisations. The African Private Equity & Venture Capital Association (AVCA) lists only eleven investors, including CDC, classified as based in UK or with some UK office representation as active limited partners. Many of these are non-UK investors with a small London presence and are neither UK operations nor mainstream institutional investors.

Knowledge and understanding of DFIs and the assets they hold are limited amongst interviewed UK investors and this must be considered when gauging their true future appetite. There is a corresponding need for advocacy and information dissemination work.

3.4.2. Pension Funds

Exposure to African collective investments amongst UK pension funds is not common and is seldom the result of a distinct formal allocation to the continent.

According to Pensions for Purpose[20], many UK pension funds would most likely consider a potential equity allocation to emerging markets and frontier markets but would be unlikely to consider a separate allocation to the African continent. Overall, regional emerging markets investment has declined in popularity in the UK in recent years and any allocations to frontier markets are still relatively small, particularly in the local authority pension fund sector. Where there is a frontier exposure it is limited to listed equities and the manager often holds emerging markets with a small sub-allocation to frontier markets. For example, one local authority representative outlined a 5% allocation to emerging markets, within which 15% were earmarked for frontier markets. Africa would in turn receive a small portion of this sub-allocation.

Allocations to private African investments can be made within the 'alternatives' buckets that most pension funds hold, and this probably presents the most likely source of allocation for any exit-mobilisation of DFI assets. A handful of interviewed pension funds do hold individual African private funds commitments on the basis of a specific mandate, such as regional debt, but these do not form part of a formal exposure to Africa or frontier markets. There are examples of single one-off African fund investments being made to capture a particular long-term growth theme, such as agribusiness, within the alternatives bucket.

Political risk is seen as a major barrier to UK pension schemes taking on more African exposure.

20 Source: Eighteen East investor interviews, December 2020

It is quoted as the only reason by one respondent, a major pension fund pooled vehicle which to date has been held back by the higher perceived levels of financial crime risk in Africa. Deploying to other emerging markets is as a result seen as a first step prior to investing in Africa.

Private equity is considered for investment as a long-term growth opportunity rather than for any intangible impact rationale. Infrastructure is seen as an attractive asset class, and one respondent would be interested in deploying capital in this space, either through funds or directly. This respondent noted that participation is seen as more likely if an entity such as a DFI was involved, either as a co-investor or fund manager. Another respondent noted that any participation would need to be actively managed.

A further factor related to political risk is that ESG considerations are increasingly important to investors and could have implications for African investments in terms of country risk restrictions. A number of respondents stated that ESG guidelines would not be lowered for emerging markets and that the same reporting standards would be expected.

The role of investment consultants and the guidance they provide could be significant for the future growth of exposure to Africa in the pension fund market. The investment consultants who act as gatekeepers for many institutional investors exert significant influence in addition to reflecting specific client demands. Interviews with leading investment consultants suggested they are often not recommending any specific emerging markets exposure beyond China, and that they suggest using global emerging market managers best placed to allocate dynamically across regions, but with no pre-determined African exposure.

3.4.3.Endowments and Foundations

When making impact investments, the charitable foundations interviewed tend to do so with a domestic UK focus, with virtually no exposure to Africa or emerging markets investments at this stage. The pressing need to first address local issues with their scarce impact capital was the typical explanation. One respondent however maintains a circa 5% allocation to Africa through a globally diversified portfolio of impact investing vehicles, one of which is managed by a DFI. They would potentially consider direct investments into Africa and debt would be the logical first step. The continent is however still deemed as high risk and they felt blended finance features would increase the probability of such a decision.

It should be noted that foundations' impact carve-outs usually only account for a small percentage of overall endowment assets, which are most often run by external managers according to conventional mandates.

One large endowment historically held a broad African listed equity investment, but recently exited this position due to poor performance. It has however supported sub-Saharan Africa debt funds through its infrastructure and private debt allocation in a sizeable manner, reflecting a newer focus on specific asset classes rather than adopting a broadly diversified exposure. These investments were made without concessionary considerations.

Overall, respondents in this category do tend to have ESG and impact mandates, theoretically making them more disposed to development investments. These do not however currently override the need for such investments to achieve what they consider as market returns. With one endowment citing the internal return targets as being 12% for private debt and 15% for private equity, these targets may prove challenging for African investment vehicles. For example, one respondent cited a number of African private equity and private debt funds it was unable to support as a result of performance concerns, in spite of its in-principle interest in doing so.

3.4.4.Insurers and Investment Managers

Exchanges with insurance companies and their asset management arms paint a contrasted picture.

Two of the largest global insurance groups run programmes relevant to exit-mobilisation through the London-based operations of their investment management subsidiaries. One is in fact specifically dedicated to development finance, and both co-invest and work closely with DFIs. Their parent group contributed significant amounts of the original capital, but the management of third-party capital is core to their approach, and they are the custodians of valuable insights into the wider institutional capital marketplace.

One has adopted a fund of funds approach and is a co-investor with DFIs in a number of private funds. It has historically expressed an interest in listed fund structures and was supportive of the early work conducted around the creation of a secondary market for DFI fund stakes through the ImpactBay initiative conducted by Eighteen East and the Rockefeller Foundation. This is an important consideration in the context of exit-mobilisation.

The other has adopted a fund structure akin to a two-tranche collateralised loan obligation (CLO), using first loss capital from DFIs to construct a low-investment grade tranche. Much emphasis was put on this latter aspect. This approach makes it possible to satisfy the requirements of its institutional investor base and to deliver a high mobilisation ratio. Greenfield infrastructure was the initial focus, but investments in financial institutions and agribusiness are being introduced. Some of the investments made by these vehicles are located on the African continent.

It is in addition worth noting that both groups have participated in DFI led initiatives, including the IFC's MCPP platform.

Interestingly, it was mentioned that financial institutions were generally reluctant to add exposure to the financial sector to their portfolios, and that this applied to their emerging market exposure. One respondent highlighted that a case needed to be made to highlight the different dynamics of SME lending on the African continent to address this hurdle.

At the other end of the spectrum, one of the largest UK insurance groups indicated that they had no significant exposure to the African continent and were not at present envisaging any significant changes to this state of affairs.

The UK's insurance sector is regulated by both the Financial Conduct Authority (FCA) and the Prudential Regulatory authority (PRA), which is part of the Bank of England. The PRA enforces capital adequacy rules that in turn determine the level of risk the institutions it supervises can take. These rules incentivise institutions to focus on investment grade debt instruments, and the investor outreach conducted for the purpose of this study confirmed that this constituted a hurdle to investment in emerging markets in general and in Africa in particular, given the scarcity of investment grade securities available in these geographies.

The insurance sector, either directly or through its investment management operations, is visibly a first institutional mover towards development finance assets.

It is however equally evident that this is not uniformly observed, and that shared experiences and advocacy need to be brought to bear to unlock its potential.

Wealth management

Although the scope of the investor engagement was focussed on institutional investors, it was deemed useful to engage with the wealth management subsidiary of a large UK asset management group, given the sector's systemic relevance to listed products and support for the impact investing concept.

It currently maintains a low exposure to the African continent and only invests in developing markets within 'sustainable' portfolios investments through allocations to its impact fund management subsidiary accounting for circa 1.5% of portfolios. This link however probably predisposes it to a certain extent to investment in developing countries. Exposure to emerging markets developmental assets would be achieved through the alternatives bucket. As would be expected from a wealth manager, an exchange listed structure would be deemed attractive. In contrast to most institutional investors there is some degree of flexibility on returns and the need for a more realistic view on returns to facilitate diversification into these new regions was acknowledged. Returns would however have to at least match developed markets for that asset class and there would also need to be an attractive yield.

4. THE INSTRUMENTS OF EXIT-MOBILISATION

4.1. CONTEXT & OBJECTIVES

DFI holdings in Africa present a clear picture. As discussed above, loans and credit facilities make up the bulk of commitments made, distantly followed by private equity funds and direct equity participations. Within the loans component, the financial institutions and infrastructure sectors, particularly the power component of the latter, account for the lion share of commitments.

From an exit-mobilisation perspective, this is what is on offer, and any opportunities must be identified within the boundaries of these realities. Before these opportunities can be tested against investor demand, the instruments through which existing DFI exposure can be transferred to private sector investors must be catalogued, and the most appropriate structures singled out. This needs to be done with full consideration being given to regulatory and fiduciary frameworks, but also to the concepts of replicability and scalability. Capital markets are far more proficient at replication than innovation, and particularly when a new element is introduced, whether it be geographical or sectoral, it is preferable to make use of a tried and tested instrument familiar to the targeted investor base.

Setting aside the sectoral dimension, the review of the instruments of exit-mobilisation must be conducted along two main categorisation avenues: the underlying category of the exposure (i.e. direct lending, private equity funds, direct equity) or the type of the instrument used (i.e. direct, fund/portfolio, securitisation vehicle). The universe of instruments will be catalogued using the latter dimension as a first subdivision, subsequently interrogating the relevance of each instrument for each category of exposure. Given that this study forms part of the wider MOBILIST programme, the focus will be on exchange listed instruments and the opportunities inherent in the use of public markets.

4.2. LISTED COLLECTIVE INVESTMENT SOLUTIONS

4.2.1. Closed-End Investment Companies

Given their suitability to illiquid and private underlying assets, London listed closed-end investment companies (CEICs), including UK domiciled CEICs qualifying as investment trusts under tax law, should be seen as relevant instruments of exit-mobilisation, since private, unlisted instruments make up the bulk of the DFI held assets as outlined earlier.

A CEIC is associated with a fixed pool of capital raised through its initial public offering (IPO). Its underlying portfolio is not affected by the secondary market transactions which allow investors to enter and exit through market liquidity as illustrated below. It does, as a result, offer a more appropriate access structure for illiquid assets than the more conventional liquid structures such as open-ended investment companies (OEICs) and other open-ended UCITS vehicles.

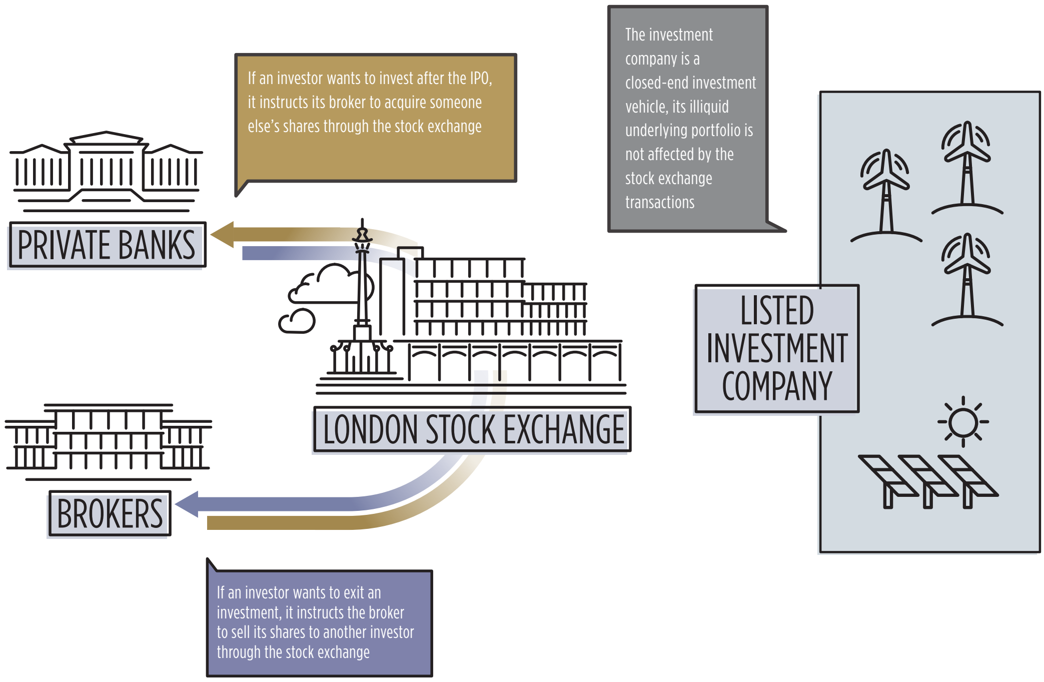


Figure 20: CEIC separation of investor/portfolio liquidity[21]

Whilst it is not within the scope of this study to do so, the 2017 CEIC toolkit[22] published by Eighteen East with the support of the Rockefeller Foundation provides a detailed exposé of the CEIC launch process.

CEICs can accommodate a wide range of underlying assets and allow for either a direct or intermediated model. A 'C' share mechanism designed to mitigate the cash drag resulting from the raising of additional funds allows CEICs to grow their capital base once the portfolio is substantially invested and assuming performance has been satisfactory. CEICs are a long established and proven route for investors in the United Kingdom to access specialist portfolios of illiquid assets. The growth areas on the LSE have been in alternative assets and real assets such as infrastructure. The latter is particularly relevant to exit-mobilisation given it is one of the main sectors of DFI focus. CEIC investors in infrastructure are generally seeking low volatility, often government backed assets, with stable and attractive net GBP yields typically in excess of 5%.

21 Source: Eighteen East CEIC toolkit
22 Available at: http://www.18eastcapital.com/wp-content/uploads/18E_RF_Toolkit_Final_GIIN.pdf

Investment trusts abroad: India's Infrastructure Investment Trusts (InvITs)

The advent and growth of the Indian InvIT sector showcases the potential of adaptation of the CEIC model to local capital markets. The Securities and Exchange Board of India's (SEBI) InvIT Regulations act of 2014 allowed Infrastructure vehicles to be registered as trusts and to list on either the National Stock Exchange (NSE) or the Bombay Stock Exchange (BSE). This coincided with the Indian government's increased focus on the sustained development of infrastructure in India, and the first vehicle was listed in 2017. 15 InvITs have at the time of writing been registered with SEBI. They can invest in the communication, social and commercial infrastructure, transport and logistics, energy and water and sanitation sectors.

Examples include India Grid Trust, which had assets under management of INR 139 billion (USD 1.9 billion) as of December 2020, was sponsored by KKR and focuses on power sector infrastructure as well as IRB's InvIT Trust. With a market capitalisation of approximately USD 440 million it is focussed on road assets and 35% of its shares are held by foreign investors, including the government of Singapore as well as OEICs managed by Schroder's and Aberdeen.

InvITs are subject to a number of eligibility requirements many of which pertain to the status and track record of the sponsor and investment manager. The trust's sponsor is required to hold a minimum of 15% of units after the initial offer subject to a three-year lock-in. Recent regulatory developments include the introduction of a regime for unlisted InvITs, guidelines on further issuance and rights issues and measures aimed at attracting foreign investors.

African CEICs on the London Stock Exchange

Few LSE listed funds currently provide or have historically provided exposure to the African assets. The market footprint has been under downward pressure and the remaining only dedicated African CEIC listed on the LSE is in run-off mode. The Africa Opportunity Fund, a public equity vehicle managed by Africa Opportunity Partners Ltd, was admitted to trading on AIM in July 2007 and moved to the Specialist Fund Segment in 2014. The fund's performance suffered from the difficult African listed equity markets and its shares have traded at a discount to NAV for much of its life. Its market capitalization is now only USD 16.8 million. Significant shareholders have historically included City of London Group and Aberdeen Frontier Markets.

Another Africa-focussed fund, the PME African Infrastructure Opportunities PLC (AIM: PMEA) was admitted to AIM in 2007, with the objective of investing in infrastructure projects in sub-Saharan Africa. In 2012, shareholders sought to realise the remaining assets of the company and return proceeds and the company was delisted in 2020. The Aberdeen Frontier Markets Trust once had a 36% allocation to African equities, most significantly Nigeria, Kenya, and Egypt, but it was itself placed into liquidation in August 2020. A number of broader LSE listed emerging markets vehicles still exist, generally allocating less than 10% of their assets to African equities.

There are a number of considerations which can both determine the investment integrity and the likely success for any CEIC IPO, some of which should specifically be integral to any African exit-mobilisation CEIC launch discussion. Although the primary role of the 'exiting' DFI would be to provide an exit-mobilisation CEIC with a portfolio of assets, the DFI could potentially have additional responsibilities.

The CEIC would require either an investment manager or an investment adviser. The involvement of the 'exiting' DFI in the management of the CEIC's portfolio would most likely be seen as a positive by investors, as its investment teams will be deemed to have superior knowledge of the underlying assets. Since the CEIC will in theory outlive its first batch of investments, the unique access to pipeline and origination capacities of a DFI would prove equally attractive. The DFI would of course be remunerated for the provision of investment management or investment advisory services, potentially allowing it to build additional capacity.

The typical CEIC structure requires a team of service providers to be assembled for the CEIC to be operational. Second only to the investment manager or advisor in importance is the CEIC's independent board of directors. The board is tasked with the protection of shareholder rights and interests. Should it not elect to play the role of investment manager or adviser, the exiting DFI could and should be represented at board level, thereby lending the CEIC expertise, credibility, and continuity.

Many of the LSE listed CEICs are domiciled in the Channel Islands. Although these offshore CEICs are subjected to more flexible rules, the 'optics' of using offshore locations should be taken into consideration and may be deemed inappropriate in the context of DFI sponsored exit-mobilisation. Some Channel Islands domiciled CEICs have, over the recent years, been re-domiciled to the UK as a result of the OECD's efforts to tackle tax erosion. HICL, a large infrastructure CEIC is a recent example of such a re-domiciliation.

Aspiring LSE listed CEICs should aim to exceed the GBP 100 million threshold that many investors unofficially see as a minimum in the context of liquidity and the due diligence resources they need to deploy to support an IPO. Since DFI African assets would be considered a new asset class, significant support from pre-IPO cornerstone investors would be needed to enhance the CEIC's prospects of a successful launch. Several attempts at CEIC launches in the impact investing space have in the last three years failed for lack of such cornerstone support. The recent BSC/Schroders impact fund is the one exception, as it listed on LSE in December 2020 with a majority of its GBP 75 million of assets having been committed by related and supportive parties.

The DFI could choose to retain an exposure through a partial swap of assets for CEIC shares at the IPO stage. This would make the DFI a cornerstone investor in the CEIC with no cash outlay, reassure investors through the resulting alignment of interests and send a strong message to the market.

CEICs are often seen as quasi-permanent capital vehicles and the long-term investment stance this allows is an attractive feature in the context of exit-mobilisation. Discounts are however an inescapable feature of any CEIC conversation, particularly where they provide exposure to illiquid assets, and investors will expect discount management clauses to be built into the structure. This could take the form of a continuation vote put to shareholders after a certain number of years, potentially causing the CEIC to be put into run-off mode. Alternatively, the exiting DFI may offer to buy back a limited portion of the assets on a periodical basis.

CEICs can be used to provide exposure to a wide range of assets. Some of the more relevant in the context of exit-mobilisation are discussed below:

Debt

- CEICs offering access to debt portfolios have been particularly successful, as witnessed by the number of such listings on the LSE, in part driven by the strong demand for yielding assets. DFI loan portfolios could present investors with an opportunity for geographic diversification into frontier markets. The most directly comparable to DFI asset holdings are CEICs giving exposure to loan portfolios, infrastructure debt and structured finance CEICS. Structured finance portfolios are generally comprised of CDOs and mortgage-backed securities, demonstrating the relevance of the CEIC model for complex underlying instruments. There are at this stage no vehicles specifically targeting emerging market loans.

Direct Equity

- Listing the unlisted equity stakes held by DFIs through a CEIC structure is an option, should a specialist fund manager be employed or the DFI retained as the investment adviser to the CEIC. The direct private equity vehicles currently listed on the LSE tend to be either specifically managed portfolios, co-investments alongside the investment adviser, or act as a feeder to a limited partnership fund run by the investment adviser to the listed vehicle. Infrastructure equity, particularly renewable energy, could present an opportunity. The IFC AMC has for some time been looking to launch a vehicle comprised of some of the IFC's existing direct equity investments. Such a vehicle could conceivably be structured as a CEIC.

Funds

- CEICs can be, and have been, structured as funds of funds. This has specifically historically been applied to private equity, and the Impact PLC blueprint[23] developed with the support of FCDO, Switzerland's SECO and the Rockefeller Foundation indeed proposed the listing of a portfolio of private equity fund participations co-investing with and managed by a DFI. Fund of funds structures are associated with a double layer of fees and CEICs operating as funds of funds have consequently been declining in popularity, with many converting to direct investment or co-investment strategies.

23 Available at: http://www.18eastcapital.com/wp-content/uploads/18E_DFID_Test_Marketing_Report_Final_web.pdf

Setting a precedent: an experience-based cautionary tale

The Eighteen East team has extensive experience of fund raising for and acting as corporate brokers to LSE listed CEICS. The successful introduction of the first vehicle in a new theme or asset class to the CEIC sector has often ushered in a period of strong growth in this sector, as the market seeks the means of diversification through alternative and complementary offerings. It is in addition true that follow-on share issues are an easier exercise than the IPO itself, and that the c-share mechanism allows for an accelerated asset growth as excess-demand materialises. As liquidity is enhanced by larger market capitalisations and wider investor bases, the attractiveness of both individual counters and the aggregate sector is reinforced. As demonstrated by the continued success of the renewable energy CEIC sector, which will be discussed below, market creation in the CEIC sector can be a virtuous circle.

Conversely, the launch of a sub-optimal first vehicle can have enduring adverse consequences for the theme or asset class it belongs to. There have historically been several situations where a first-mover fund 'scraped through', sometimes requiring a last-minute, oversized capital injection from a related party. With a small launch size and a narrow shareholder base, it is difficult for secondary market liquidity to emerge. Where the underlying assets are private and illiquid in nature, infrequent NAVs mean the market is unable to gain confidence in the underlying portfolio performance. All these factors could contribute to a failure causing lasting damage to the wider opportunity CEICs represent for the sector. Prospective CEIC sponsors should learn from previous mistakes.

Size matters, but liquidity is everything: build a wide and diversified investor base

It might be tempting to focus on institutional investors, whose average ticket size holds the promise of large headline numbers. The natural liquidity generated by wealth managers and retail investors is however key to the CEIC concept. A diversified shareholder base, and a continuous effort to further add new investors post-IPO are key to the lasting success of the first launch, and therefore to that of the sector. Market-makers play a key role in providing 'systemic' liquidity, and a focussed effort should be made to attract as many of them as possible to offer their services to the first issue.

Size is however a key factor, and from the MOBILIST standpoint, there should be a strategic focus on delivering a sizeable first IPO rather than to spread the initiative's bets. A flagship vehicle offers the highest probability of a thriving sector.

Governance is not negotiable, neither is an exit door

Given the illiquid nature of the underlying assets, it is important that investors be reassured that there is an exit path beyond the secondary market for the CEIC's shares. A continuation vote and buy back powers should at a minimum be enshrined in the prospectus and protected by a board fully independent from the CEIC's investment adviser or manager.

Yield it and they will be more likely to come

It is becoming increasingly difficult for developed markets CEICs to provide investors with the hard currency yield they have become accustomed to without resorting to leverage. This is, for example, observable in the renewable energy space and should present an opportunity for exit-mobilisation in general and African DFI assets in particular.

Cherry picking

Given the time to deployment associated with many private assets strategies, providing investors with a fully deployed portfolio would limit the cash drag and render any issue more attractive. Given the lack of familiarity with African assets in general and DFI portfolios in particular, and the exemplary value of a first vehicle, there should be a resolute effort to offer the best performing assets as a starting point. This requires a clear political on the part of DFI management and shareholders. Investment teams may otherwise – and understandably – be reluctant to part with high quality assets.

4.2.2. SPACS

Special Purpose Acquisition Companies (SPACs) are formed to raise capital through an initial public offering (IPO) for the purpose of then acquiring an existing company or portfolio of stakes. A SPAC has a specific period of time in which to identify a target, during which the funds are held in trust. Should no such acquisition materialise, the SPAC is dissolved, and the funds are distributed back to its shareholders.

The structure should be given some consideration here by virtue of its public market listing and the recent and rapid growth in interest it has generated. According to the Financial Times[24], SPACs "accounted for just under USD 76 billion of the record USD 159 billion raised through floats in the US" in 2020. The traditional rationale for SPACs would be to identify a target company to acquire by way of reverse merger, but the structure could in theory be used to fund the acquisition of a portfolio of assets from a DFI.

SPACs do in theory offer more flexibility, faster access, and fewer regulatory hurdles than CEICs. It could be argued that the success or failure of a SPAC's fund raising is predominantly driven by the quality, reputation, and track record of the management team. In the context of exit-mobilisation, its ability to source and execute transactions from one or more DFIs would be key. As with CEICs, in addition to selling the assets to the SPAC, the DFI could be the sponsor of or act as the vehicle's manager, and in some cases would be expected to be an investor. SPAC sponsors are expected to retain an equity stake after the IPO is completed. Although it brings the ability to select and acquire assets from DFIs over a period of time, it is questionable whether the SPAC model presents any concrete advantages over the CEIC structure. Introducing a relatively unfamiliar structure as well as a new asset base to the London market simultaneously might be too ambitious and SPACs may not be deemed suitable by many of the larger UK institutional investors.

An early SPAC experiment: Atlas Mara

Co-founded by Bob Diamond, former CEO of Barclays PLC, British Virgin Islands headquartered Atlas Mara Limited listed on the LSE in November 2013 as a SPAC, raising USD 325 million through its IPO, followed by a further USD 300 million through a private placement in 2014. The SPAC was over the years in addition able to secure loans from lenders ranging from OPIC, Standard Chartered and UBS to the German KfW/BMZ backed AATIF.

It quickly spent USD 265 million on the 2014 acquisitions of African Development Corporation, a Frankfurt-listed holding company whose assets at the time included stakes in BancABC and Union Bank of Nigeria (UBN), and concurrently of the remaining shares of BancABC. Later that year, the SPAC increased its holding in UBN through the purchase of a 20.9% stake held by AMCON, an entity created by the Nigerian government to buy out banking assets in the wake of the financial crisis. Atlas Mara further acquired the commercial assets of the Rwandan Development Bank, which it later merged with Banque Populaire du Rwanda, which it acquired a controlling stake in the following year. The acquisition spree culminated in 2016 with the purchase of Finance Bank of Zambia (FBZ) which was duly combined with BancABC Zambia.

The SPAC has since seen turbulent times, with Canada's Fairfax Africa taking control in 2017, standstill negotiations being entered with creditors and Diamond stepping down as executive chairman in 2019. Atlas Mara is currently involved in several disposal discussions that have already seen the sale of ABC Mozambique to Access Bank.

It is not necessary to explain the misfortunes that led to the collapse in Atlas Mara's share price. It is however useful to take note of the criticisms levelled at the costly management structure, with a 2015 cost-to-income ratio of 95% according to The Africa Report[25]. More generally, the risks associated with 'blind pool' vehicles combined with relatively light governance in place should be kept in mind when considering SPACs over CEICs.

24 https://www.ft.com/content/80458983-1693-4022-ba23-113925d24d70
25 https://www.theafricareport.com/50618/atlas-mara-what-went-wrong-in-the-african-banking-venture/

4.3. SECURITISATION

Securitisation techniques can be brought to bear to bridge the gaps separating the frameworks DFIs operate within from those relevant to private sector institutional investors, whether they be linked to risk, liquidity, tenor, or regulatory compliance requirements. Financial engineering has long provided solutions to such issues. In the DFI context, they can allow for the effective transfer of the risk linked to specific pools of assets to private investors, allowing DFIs to both recycle their own capital and mobilise private capital. They should therefore be given due consideration in the context of exit-mobilisation.

4.3.1. True-Sale Loans Securitisation

In the context of exit-mobilisation, true-sale securitisation would involve the transfer of a portfolio of loans from a DFI to a SPV.

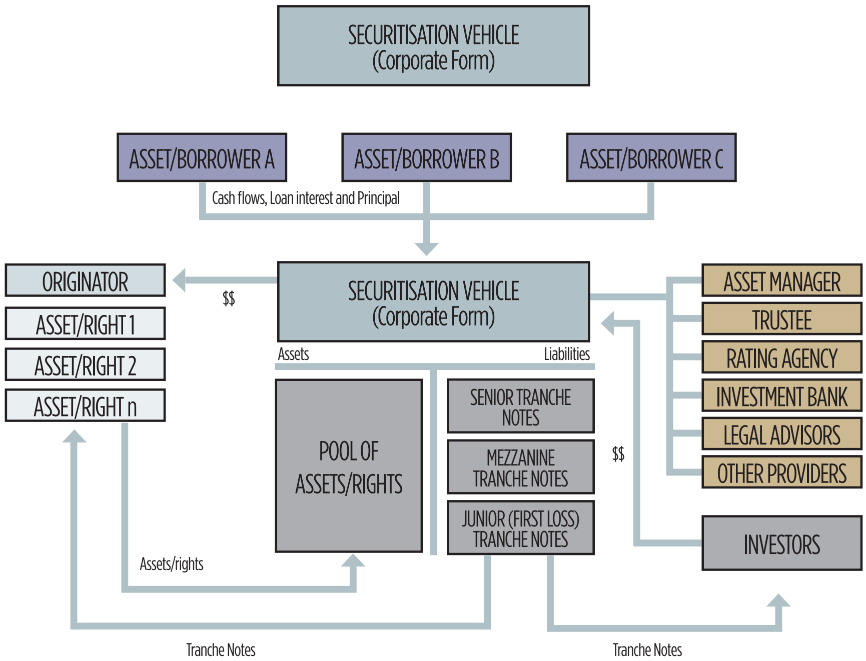


Figure 21: True-Sale Securitisation (source: Eighteen East SDC Report)

As illustrated in Figure 21, this SPV has its own capital structure, which includes an equity layer but can also feature several debt issues of differentiated seniority. This in turn means that the risk profile of individual debt 'tranches' issued by the SPV to investors is different from that of the portfolio as a whole. This is a crucial concept in the context of mobilisation, as this presents the opportunity to issue notes that can be tailored to the requirements of different categories of investors. CRAs can in turn be approached to issue a rating for a specific tranche of notes, a necessary step to attract some categories of institutional investors.

Although they are not uniform across jurisdictions, securitisation regulations usually prescribe that the originator, in this case the DFI, should retain an exposure to the securitised portfolio. Should this exposure be junior to a tranche of notes issued to private investors, it does represent an enhancing 'blended finance' feature.

With the MOBILIST agenda in mind, it is worth noting that securities issued by the SPV can, and usually are, listed on exchange, if seldom associated with significant secondary liquidity. The choice of the regulatory jurisdiction will be a determining factor for investor adoption.

There are several potential limitations to the use of true-sale securitisation for exit-mobilisation.

Whilst the Collateralised Loan Obligations (CLO) model is a tried and tested structure that most market participants have institutional knowledge of, it is associated with a level of complexity and costs only warranted if scale can be achieved. This in turn means that it would require the identification of a sizeable loan portfolio within a DFI. A securitisation across multiple DFIs would be helpful in this regard but would come with its own additional layer of complexity.

Applying this approach to term loans, prevalent in the infrastructure portfolios of DFIs would be relatively straightforward, but the credit facilities extended to financial institutions would prove more challenging.

An option could be for the DFI originator to act as the loan agent, hence remaining in charge of servicing the loan post novation to the SPV. This type of clause is not commonly present in loan agreements and may cause friction between the SPV's investors and the DFI, in particular in extreme events such as restructuring or default. The DFI and the investors may have diverging views on resolutions, not to mention time frames.

4.3.2. Synthetic Securitisation

Synthetic securitisation refers to a scenario where the exposure to a portfolio of loans or other instruments is 'contractually' or 'notionally' transferred to investors, rather than 'physically' as is the case with true sale securitisation. In the context of exit-mobilisation, this means that the loans would remain on the DFI's balance sheet, but that part of the associated risk and returns would be transferred to an SPV through a contract.

The 'Room2Run' transaction entered by the AfDB constitutes an important precedent. Its notoriety is arguably as much a reflection of its ground-breaking nature as of the fact that it has thus far not been replicated.

The application of synthetic securitisation is discussed at length in Eighteen East's Sustainable Development Certificates report published in March 2020 with the support of the Rockefeller Foundation[26].

The synthetic approach does address some of the issues associated with its true-sale alternative highlighted above. The DFI remains the legal counterparty for the recipient of the loans, it is a more flexible instrument given its contractual nature and therefore lends itself better to smaller transactions or transactions that can be scaled over time and tailor-made to accommodate specific investor profiles, geographical focus, sector concentration or tenors.

The DFI's counterparty can also be an SPV, which in turn is able to issue securities to private sector investors. It is important to note that this ability to 're-securitise' is in some instances limited by the regulator, as is for example the case with the European Union regulation. Since synthetic securitisation is typically done on a specific 'tranche' of the securitised portfolio, it does however still present the opportunity to issue securities whose risk and return profile differs from that of the original portfolio, and synthetic CLOs securities can also be listed on exchange.

The main difficulties associated with this approach include the management of counterparty risk and margin calls by the DFI, a lower level of capital relief compared to a true-sale securitisation, and the necessity to price the risk transferred from the DFI to the SPV through the contract, an exercise rendered difficult by loan markets associated with a lack of transparency and limited access to historical data.

4.3.3. Funds Securitisation

Whilst it is true to say that most securitisation transactions occur with debt as the underlying exposure, securitisation techniques have been and continue to be applied to other asset classes, including infrastructure and private equity.

On the private equity front, 'Collateralised Fund Obligations' (CFOs) have been an infrequent but existing feature. Singapore's Temasek has for example launched a few such structures through its Azalea Asset Management subsidiary. The assets of the SPV are here participations in private equity partnerships, which may be purchased as the result of secondary transactions to shorten the investment horizon and avoid the first part of the J-curve, a particularly attractive feature for investors. CFOs also issue debt instruments to investors. This is only possible when there is a high degree of certainty on future cash flows amongst investors and is therefore difficult to transpose into the DFI context, particularly on the African continent where performance has often failed to meet the managers' own targets.

4.3.4. The MOBILIST Opportunity

Securitisation techniques are directly relevant to the exit-mobilisation agenda. They represent a set of tried and tested tools that can be used to both transfer and adapt exposure to a set of institutional investors operating in a framework that differs from that of

26 http://www.18eastcapital.com/wp-content/uploads/18E_SDCReport03202020.pdf

DFIs. They are not just relevant in the context of mobilisation, but also as a tool for the optimisation of DFI balance sheets, ensuring they can do more with the resources at their disposal.

The notes issued by CLOs can be listed on stock exchanges, and there have been examples of LSE listings of closed-end investment companies investing in either the debt or the equity issued by CLOs.

Their inherent complexity, perceived or real, does however mean that they may not be the most appropriate route until investors acquire a higher level of familiarity with the underlying assets, and are as a result willing to consider departing from the basic building blocks of their portfolios. Given significant scale will need to be reached for securitisation vehicles to take full advantage of public markets, it might be best to see them as a medium to long term opportunity. It is however worth observing that one of the largest private asset managers active in the development finance space uses a model close to that of a two-tranche CLO to mobilise its private institutional investor client base.[27]

4.4. DIRECT EQUITY AND DEBT

Well-honed capital market processes for raising equity and debt offer established routes to capital raising, a wide variety of products and structures, and predictable and transparent contracting processes. The capital markets of the global financial centres must be harnessed if exit-mobilisation and private capital mobilisation are to occur at scale. Equally, as has been established in Section 2 of this report, local East African capital markets have made great strides in recent years and have proven their ability to facilitate a growing variety of transactions.

Traditional equity capital market avenues include IPOs, private placements, accelerated book-building (i.e. secondaries or block trades), and the associated marketing, distribution, and allocation of such transactions.

Globally, debt capital markets are comprised of a wide range of products and dwarf equity markets in volume. Local African debt markets however remain relatively underdeveloped and are characterised by a vast preponderance of government securities both in primary and secondary markets. This dynamic may be changing, and the recent introduction of green bond frameworks in Nigeria and Kenya has contributed to a revival in local corporate debt markets.

4.4.1. Africa and the London Stock Exchange

Current Footprint

According to the LSE, the equity of 122 African or Africa-focussed corporates is currently listed on its markets. At over GBP 143 billion, the collective worth of African companies on the LSE is second only to those listed on the JSE. In 2020, FTSE Russell launched the FTSE UK Listed Africa Index, featuring 65 London-listed companies with a combined market cap of GBP 105 billion to reflect this. It must be noted that many of these listings are comprised of blue-chip corporates, many of which are either South African or belong to the mining sector. The LSE is in addition home to a significant universe of African debt listings, with over 50 active bonds from 18 issuers. However, 81% of these bonds are issued by African sovereigns.

Listing Regulation

The LSE 's flagship Main Market is regulated by the FCA. As the UK's regulatory authority responsible for listing, the FCA determines the criteria for admission to the Official List and decides which continuing obligations must be met by issuers. The FCA does not typically express specific opinions on geographies and should not therefore have a view on Africa per se. However, there have been instances where the perception of risk has caused the FCA to conduct additional due diligence around African individuals or African companies.

There are no geography-specific regulatory barriers that would prevent the listing of African assets, as evidenced by the large number of African equity and bond offerings on the LSE. There are several African domiciled companies already listed on the LSE's market segments. These tend to be concentrated on either the standard segment or the AIM market given their less onerous requirements. A number of African companies have redesignated their domicile to the UK to graduate to a premium listing which may appeal to a wider variety of investors and have more international recognition.

27 Source: Eighteen East investor interviews, December 2020

Market Segments and Implications

Most instruments considered in this study can be listed on one or more of the LSE segments, and the underlying DFI assets are unlikely to fall foul of regulatory hurdles. Up to date information pertaining to listing criteria and continuing obligations is best found on the LSE's website[28].

The LSE is home to several segments and there are significant differences between the main market and 'exchange regulated markets' such as AIM, the Specialist Fund Segment (SFS) or the International Securities Market (ISM). The general principle is that recognition, both by regulators and investors, foreign and domestic, is positively correlated to how demanding each individual segment's listing criteria and continuing obligations are. 'Exchange regulated markets' are easier and cheaper to list on and impose a lighter ongoing burden on listed entities and the sponsors of listed instruments.

Whilst these 'junior' markets constitute the logical route to an LSE listing for many emerging market sponsors given their lower costs and criteria, including accounting standards and track records, their use mechanically limits the investor base they can raise funds from. This is both true at the domestic level, where some of these segments are only accessible to sophisticated investors, or on the global stage, where they may not be universally recognised.

It is however worth keeping in mind that unless the prospective issuers use IFRS, GAAP or equivalent accounting standards, it would be necessary to envisage a listing on those segments, such as the Professional Securities Market (PSM) that allow for the use of the issuer's local accounting standards.

The choice of a listing segment has consequences where a dual listing is envisaged.

The LSE has fast-tracked dual listings protocols in place with several relevant stock exchanges.

These do not however cover all segments. Recent conversations held with the JSE around the dual listing of the shares in a CEIC for example highlighted that the fast-tracked dual listing protocol was available for a premium listing on the main market, but that the JSE did not at the time recognise the SFS.

In the context of MOBILIST and exit-mobilisation, the selection of the appropriate listing segment is particularly important. Since the objective is to attract new and additional sources of capital to assets that until now were largely the preserve of DFIs, and whose risk profile is often perceived as a hurdle by investors, it might be judicious to set aside considerations of cost and ease and strive to achieve the highest feasible standard of listing to reassure prospective investors.

4.4.2. Direct Exit-Mobilisation: Trailblazers and Opportunities

When considering exit-mobilisation opportunities through capital markets, be they local or global, DFIs could elect to list some of their direct private equity holdings and they could sell their holdings of already listed stocks and bonds.

Whilst the above avenues may be plausible exit-mobilisation opportunities the realities of capital markets must be confronted when considering the correct course of action. In many instances likely exit-mobilisation transactions will be characterised by relatively high levels of complexity, small ticket sizes, and underdeveloped market environments. This is however not always true and there are precedents for high quality DFI holdings successfully harnessing capital markets to raise institutional capital and provide exit opportunities for DFIs. Helios Towers, through its LSE IPO and successful bond issuance is a useful example of what can be achieved.

28 Available at: www.lse.ac.uk

Helios Towers: Tapping Global Markets for equity and debt

Equity

Helios Towers owns 7 000 mobile communications towers across the African continent, mainly located in the Democratic Republic of Congo, Congo-Brazzaville, Ghana, Tanzania, and has recently established a presence in South Africa. Helios further intends to increase its presence in several African countries, including Senegal, Morocco, Angola, and Ethiopia.

The company was established in 2009 and Helios first applied to list on both the LSE and the JSE as early as April 2018. The listing was postponed due to concerns centred around political risk in the DRC and Tanzania, despite Helios saying it met with considerable investor interest. The IPO was completed on the LSE in October 2019 and it became a FTSE 250 constituent at the same time. The company raised GBP 250 million (USD 317 million) through its IPO, setting its overall market value at GBP 1.15 billion (USD 1.45 billion). The IPO allowed existing shareholders including the IFC to reduce their stake.

Debt

In June 2020, Helios Towers successfully issued USD 750 million in new corporate bonds through one of the first issues by a private sector company in a developing country since the outbreak of the pandemic.

EAIF acted as an anchor investor in the bond issued in London by HTA Group, a wholly owned subsidiary of Helios Towers. EAIF invested USD 30m in the UK listed bond, which has a 5.5-year term to 2025 and a coupon of 7%. Although the initial target was set at USD 425m given the difficult backdrop, the issue was heavily subscribed, and Helios raised USD 750m, allowing a full redemption of its existing 2022 notes. Consequently, EAIF scaled back its investment to USD 30m, having initially committed up to USD 60m, to allow more private investors to participate. DEG subscribed to the issue as an anchor investor supporting its long-standing customer. The issue was also included in mainstream ETF's, notably iShares Emerging Markets High Yield Bond ETF and iShares J.P. Morgan EM Corporate Bond ETF

Helios subsequently raised an incremental USD 225 million through a tap issue priced above par. Moody's Investors Service affirmed the "B2" LT- foreign currency credit rating of Helios Towers in September 2020.

Providing an additional precedent, in 2020 Norfund sold its shares in SN Power to Oslo-listed Scatec Solar for USD 1.17 billion. SN Power was created by Norfund and Statkraft AS (a Norwegian government-owned hydropower company) in 2002 to invest in hydropower assets in developing countries. It held stakes in projects in the Philippines and Laos, as well as a majority ownership stake in the Bujagali Hydropower Project in Uganda. SN Power was 100% owned by Norfund at the time of sale.

This was a significant and large-scale exit to a public listed company that perfectly demonstrates the power of exit-mobilisation, as described by Norfund's CEO Tellef Thorleifsson at the time:

"This deal means that we can quickly reinvest our capital. Teaming up with existing and new partners, we will capture opportunities in renewable energy that we so far have had to turn down."

Observing these examples prompts the question of where else such opportunities might reside. Based on the research conducted for this report two potential candidates emerge:

- Arise B.V. is an investment holding company owned by Norfund, FMO, and Rabobank. It constitutes a sizeable and diverse portfolio of local financial holdings.
- Globeleq develops, owns, and operates power plants across Africa, and is a leading independent power producer on the continent. It is owned by CDC (70%) and Norfund (30%). Globeleq offers several similarities with the Scatec / SN Power deal, which serves as an interesting precedent and provides some indication of the appetite for such assets.

Assessing available precedents, observed market demand, and investor feedback both Arise and Globeleq could conceivably be thought of as candidates for exit-mobilisation through listing.

4.4.3. Covered Green Bonds and COPs

In the context of debt capital markets exit-mobilisation there are a few instruments at the intersection of straight issuance and securitisation that are worth investigating. Covered bonds and Certificates of participation are linked to specific assets or pools thereof, but do not transfer asset specific risk (or return) from the DFI to investors. Their relative simplicity is however an advantage they share with straight debt issuance.

Covered bonds have attracted significant attention, particularly in their application to green bonds issuance. Covered bonds are issued by financial institutions and give investors a preferred claim on a specific portfolio of assets as well as a normal claim on the rest of the issuer's assets. They are 'dual recourse' instruments. Depending on the regulatory environment, covered bonds might be granted preferential treatment in the context of investors' capital requirements. Covered bonds being linked to an identified pool of underlying loans may in addition present the advantage of addressing concerns of 'greenwashing' or 'impact-washing'.

This pool of loans remains on the issuer's balance sheet, a characteristic shared with the synthetic securitisation model. There is however no specific risk transfer mechanism, and the issuance of covered bonds does not provide the financial institutions with the regulatory capital relief associated with synthetic securitisation. It is however also a much simpler endeavour.

The United States' DFC, formerly known as OPIC has long resorted to a unique form of debt issuance, linked to single projects, and incorporating a built-in guarantee from the US government. The Certificates of Participation (COPs) model is worthy of interest, although they rely on the very specific way in which the DFC is set up and their structure would likely need to be adapted to the relevant jurisdictions.

A unique debt issuance model: The DFC's Certificates of participation (COPs)

Certificates of participation were pioneered and are used by the United States' DFC to raise private capital to fund the projects it supports and that are aligned with its principles. The private capital is raised through the issuance of COPs by a placing agent on the US fixed income debt capital markets.

Although the loan agreement is between the DFC and the borrower, the proceeds from the COPs issuance are now directly transferred from the placing agent to the borrower. COPs are associated with individual loans, with a singular and specific use of proceeds, rather than with a pool of assets.

Only US investors are eligible. The COPs are backed by the full faith and credit of the U.S. Government. In other words, the DFC "would pay the COP holders if the borrower does not pay". The COPs bear an interest rate "pegged to various U.S. Treasury securities, or in some instances, may be based on another internationally-accepted rate" to which "DFC adds a risk premium called a Guaranty Fee"[29].

Although issues have been relatively small, there is a sizeable market float of these now outstanding, most of them offering a fixed rate with only about a third offering a floating rate. The fixed rate tranches have historically been taken up by pension funds (particularly state and municipal schemes) and insurance investors. The floating rate tranches, which are often shorter term, have in turn mostly been bought by the US mutual funds industry. The DFC does however now state that COPs will be used for transactions involving a floating base rate.

29 Source: DFC, https://www3.opic.gov/DFCForms/Documents/DFCFinanceFAQs.pdf

5. DFIs & EXIT-MOBILISATION

5.1. EXITING DEVELOPMENT FINANCE

Exit-mobilisation is, at least in theory, built into the development finance model. DFIs are tasked with addressing funding gaps and building markets until such time as economies can rely on private sources of capital to finance their development. Selling assets to private investors where and when they can be found should constitute an important part of their mandate.

In reality, at least in part because alternative sources of capital and liquidity are scarce in many of the markets they operate in, DFIs have developed a strong reliance on self-liquidating instruments, and a propensity to hold investments to maturity. Imperatives of profitability, the will to preserve the impact they generate, limited linkages to the wider capital markets, fears of cherry-picking on the part of private investors and in some instances a lack of active ownership and clear directives on the part of their shareholders are as many additional hurdles to externally driven initiatives focussed on the sale of DFI assets.

For a market to emerge, all stakeholders must find self-motivation to participate and engage.

A key priority for MOBILIST must be to engage with DFI teams, management, and owners to demonstrate the long-term, scalable benefits of exit-mobilisation for sustainable development, and how it can enhance, rather than threaten, the efficiency and sustainability of the DFIs themselves. To seize the opportunity afforded by exit-mobilisation and public capital markets, it will be necessary to ensure that DFIs are equipped with appropriate incentives and resources as well as mission-aligned objectives.

FCDO's dual role as the institution behind MOBILIST and the owner of the United Kingdom's DFI CDC represents a unique opportunity for system change.

5.2. IMPACT TRADE-OFFS

A consistently recorded concern across conversations with DFIs about asset sales to the private sector is the perceived risk this entails for the impact generated by their investments. There are two different levels relevant to exit-mobilisation where impact risk can occur:

As a result of the exit-mobilisation of existing investments:

The transfer of the legal title to or ownership of a specific investment may cause DFIs to lose control over the governance of the investment. ESG and impact frameworks it put in place may be at risk of removal by new controlling investors. These concerns are inflated where public markets are involved, as there can be no control over the impact credentials or intentions of buyers.

This risk can be mitigated through:

- Synthetic securitisation or indirect mobilisation through issuance, whereby the risk and returns are for example contractually transferred to investors, but the legal title or ownership remains with the DFI.
- Partial exit-mobilisation, whereby the DFI retains a sufficient stake to continue to exert control.
- Thinking ahead and including safeguards in the governance of the instruments. This is seldom explored given relatively few DFI investments are entered with an exit strategy of a non-self-liquidating nature. These could include different voting rights for DFI held shares, high voting thresholds for changes in impact framework, independent governance structuring, etc...
- Intermediated exit-mobilisation, whereby the DFI acts as the fund manager for a listed fund or a CLO.

As a result of DFI investment behavioural change driven by ongoing exit-mobilisation policies:

Should exit-mobilisation become part of a DFI's long-term strategy, and KPIs be defined accordingly, there is a risk that the investment behaviour of its teams is altered to facilitate this process, shifting towards opportunities believed more likely to attract private investors. This could conceivably have an adverse effect on the impact generated by the DFI. This risk can be mitigated through the adoption of appropriate governance, including Chinese walls, and differentiated KPIs separating the investment teams from the exit-mobilisation function.

5.3. NOT ALL DFIS ARE CREATED EQUAL

The mobilisation of private sources of capital is an objective common to most DFIs, although their approaches may differ. At the most basic level, they see themselves as agents of mobilisation through their provision of cornerstone capital to transactions that may attract private co-investments. Some do, in addition, raise debt on capital markets. Some have created third party asset management arms, while others have made use of securitisation or credit insurance techniques.

Although the latter do result in risk transfer, the sale of existing investments to private investors has to date not been a prominent feature of mobilisation strategies. An individual DFI's ability to implement exit-mobilisation strategies will be a function of factors ranging from its governance and incentives structure to its internal technical know-how and the size and diversification of its portfolio.

Governance:

- Where DFIs only have a mandate to manage public funds, collective investment schemes routes to exit-mobilisation may not be available, lest the investment management role is left to a third party. The obtention of the required regulatory status and of the resources required to maintain compliance would unlock the value embedded in their processes, teams and track records.
- In some instances, DFIs are not authorised to borrow. Debt-issuance based solutions (covered bonds) are as a result not applicable. Adapting legacy governance to new challenges and opportunities would here again enable those institutions to harness the potential of capital markets.
- Promulgating policies and procedures allowing or providing the framework for the sale of assets will in many instances prove a necessary first step as not all DFIs have historically had to execute secondary transactions.

Technical know-how:

- Larger organisations with a wider product-mix and considerable human resources naturally have access to a wider array of the technical skills necessary to the implementation of exit-mobilisation solutions, some of which are of a niche nature in the first place (secondary private funds sales, synthetic securitisation, etc…)
- DFIs generally have little or no distribution capacity, although those with asset management arms at times have built sales teams. Syndication teams are sometimes in place, but they do not have uniformly extensive market linkages.
- Further integration and increasing levels of cooperation with investment banks would enable smaller institutions to access external structuring and intermediation expertise.

Size and diversification:

- Difficulties in achieving yearly deployment targets may in turn mean that there is a disincentive to cede assets ahead of their maturity, as doing so may result in a negative cash drag effect on the portfolio's financial performance. Larger institutions are therefore better positioned to weather this short-term cost of exit-mobilisation.
- The use of pooling-based exit-mobilisation solutions is facilitated by the ability to build diversified but homogeneous portfolios within one asset class, one geography and one sector. This again is only possible for those institutions with sizeable balance sheets and diversified portfolios.
- Cooperation between DFIs can however address these issues, potentially facilitated through existing forums (e.g. EDFI).

There is no doubt that larger organisations such as the IFC or the EIB are better positioned to engage in exit-mobilisation with minimal disruption to their financial performance and their business model without extensive recourse to external expertise.

Multi-DFI initiatives, whilst they might seem daunting from a political and administrative standpoint, would however address the size and diversification hurdles, and an increased level of interaction with investment banks would address any lack of specific know-how.

Preferred Creditor Status

It is perhaps useful to briefly discuss preferred creditor status (PCS) as it pertains to exit-mobilisation. MDBs in particular, and to an extent their subsidiaries (e.g. the IFC) are deemed to enjoy preferred creditor status. This is not a tangible or a legal status, but rather an observed practice. It generally refers to the fact that sovereign borrowers will endeavour never to default on their obligations to MDBs, as they know them to be their lender of last resort. According to the IADB, "this confers on the loans of MDBs a type of de facto seniority"[30]. This in turn has an influence on the credit ratings of the MDBs, as CRAs build this assumed lower risk of default into their rating process. It could be argued that IFIs and DFIs might enjoy a similar practice with regards to their non-sovereign loan books, but there is little evidence or research to support this hypothesis. A broader meaning of PCS in addition refers to a currency convertibility benefit granted MDBs by their member governments. The IFC defines it thus:

"This means that member governments grant IFC loans preferential access to foreign currency in the event of a country foreign exchange crisis. The Preferred Creditor Status therefore mitigates transfer and convertibility risk for IFC and its B Loan participants."[31]

PCS in its core meaning is not a legal concept and is therefore not transferrable. It is mostly associated with loans to sovereigns and therefore does not fall within the scope of this study. If it is found to apply to non-sovereign loans, then its benefits could theoretically be retained by using those indirect exit-mobilisation techniques that leave the title to investments with the originating DFI.

With regards to the currency convertibility benefits, and though it is worth noting that they are deemed to apply to IFC B Loan participants, it is not certain that all exit-mobilisation techniques could extend the associated risk mitigation to private sector investors. This aspect of PCS is not universally enjoyed by DFIs, but whilst it certainly is an advantage, it is unlikely to be a determining factor.

A significant and consistent hurdle to exit-mobilisation across DFIs is however not of a technical nature. There is a widely observed aversion to selling assets, particularly where there exists a fear of 'cherry-picking' on the part of private investors. Where absolute deployment objectives meet with insufficient pipelines, private capital mobilisation and exit-mobilisation risk being perceived as counter-productive. Whilst selling the best performing assets in a portfolio is a feature of many forms of early-stage investing, it does not seem to be an accepted part of the development finance process. The decision to engage in the exit-mobilisation process and the willingness to accept the potentially real cost of doing so in terms of financial performance are political in nature and must be seen as the responsibility of DFI shareholders.

30 publications.iadb.org/publications/english/document/Multilateral-Development-Bank-Ratings-and-Preferred-Creditor-Status.pdf
31 www.ifc.org/wps/wcm/connect/corp_ext_content/ifc_external_corporate_site/solutions/products+and+services/syndications/preferred-creditor-status

5.4. THE CONCESSIONALITY QUESTION

The concept of concessionality is central to private capital mobilisation for sustainable development. It is invoked by various stakeholders to explain why private capital cannot be mobilised. As is commonplace in the fields of development finance and impact investing, a first hurdle to an objective analysis is the absence of a clear consensus on definition.

Equity

On the private equity funds front, there is no evidence that DFIs hold participations that rank differently from their private co-investors when those are present. If anything, an analysis of the legal documentation of private equity funds suggests that DFIs are typically able to negotiate better terms than those applicable to private investors, although these are typically not of a financial nature, but rather linked to information rights and participation in the governance of the funds.

Where direct equity investments are concerned, and particularly where these are made in listed companies, there is again no evidence of concessionality.

Debt

The situation does at first blush appear simple on the debt front. It is tempting to assume that concessionality can be readily identified and measured by comparing the interest rate charged on a loan with the 'market rate' for loans to the same entity, or comparable entities, in the same currency, for the same tenor and according to similar terms.

The absence of an observable market rate does however somewhat weaken this approach. The IFC, when attempting to calculate the concessional level of projects, tellingly solely in the context of its blended finance portfolio, provides the following explanation:

Concessionality figures are based on the difference between (i) a 'reference price' (which can be a market price, if available; the price calculated using IFC's pricing model, which comprises three main elements of risk, cost, and net profit; or a negotiated price with the client) and (ii) the 'concessional price' being charged by the blended concessional finance co-investment.[32]

The fact that the market price and the IFC pricing model are interchangeable options to fill the same data points is interesting in and of itself.

Exit-mobilisation is however in a first instance not concerned with blended finance situations, but with establishing whether the investments made by DFIs can be deemed to be concessionary, and therefore unlikely to meet the risk-return requirements of private capital. On the lending front, since they largely provide hard currency funding, and where, as a group of institutions they provide the bulk of such funding, not only is it nigh impossible to identify a market yield curve to use as the benchmark from which concessionality levels are calculated, but it can be argued in the context of sub-Saharan Africa that DFIs are the market and therefore by definition are not deviating from market rates. It is worth noting that the pricing of the observable loans extended by the EIB does stand out, and is often significantly below that of loans made by other DFIs to the same entities or projects. It would of course be important to ascertain that the access to inexpensive funding enjoyed by DFIs and their pricing approach does not at times prevent the entry of other market participants, and this should present a worthy topic for further study.

Private sector lenders have their own pricing models, which would be used to determine the pricing of their loans. They do however lack access to historical performance data. Whilst this study's mapping exercise provides information about commitments made, access to a comprehensive and systematically maintained loan performance database such as the Global Emerging Markets (GEMs) Risk Database would be necessary for them to establish their ability to align with DFI pricing, and therefore the existence and magnitude of DFI concessionality compared to what they can offer, given their own cost of capital and profitability criteria.

The elusive market rate may therefore not be a universally appropriate route to assessing the existence and the magnitude of concessionality. Where the mobilisation of private capital is the chief concern, it would make sense to posit that concessionality is in the eye of the beholder and consider it from the point of view of private investors.

32 Source: IFC, https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/bf/bf-details/concessionality-calculation

A blended view of concessionality

An important nuance must be made when it comes to the technical assistance and other like facilities that often are linked to DFI investments. These are often grant based rather than investments, and as a result the aggregate DFI intervention can be seen as deviating from what other market participants would offer.

It is in addition abundantly clear that DFIs provide capital that is often available from no other source, or according to terms other than financial that cannot otherwise be obtained. They provide loans with longer tenors, invest in first time funds, adopt a long-term view and support fund managers that have not historically met return targets and crucially create a market for capital in geographies where none exists.

Concessionality is in the eye of the beholder

Conversations held with African institutional investors are in this context enlightening. There are, as discussed above, a relevant number of situations where African investors have invested, and continue to invest, alongside DFIs on a pari passu basis. These investors do not consider themselves, or the investments they make as being concessionary. It follows that from their point of view, neither are the DFIs.

One systemically important respondent shed further light on the approach taken by large non-African investors they have been interacting with.

These non-African institutions assess the attractiveness of African investments against the opportunities they have access to globally. Whilst individual opportunities may past that test, the specific challenges facing the African continent mean that many will not. One of the UK-based institutions interviewed pointed out that DFI pricing is lower than that observed in the liquid US high-yield market, making it difficult to justify investments in an unfamiliar market with no liquidity. From the point of view of these investors, accepting a sub-optimal risk-return ratio on the basis of non-financial motivations would indeed be concessionary.
For African investors whose mandate is to invest on the continent and who therefore do not have access to a similar set of opportunities, Africa is the market, and the very same investments will not be deemed concessionary.

Conclusion

In the narrow context of exit-mobilisation, the key does not appear to be linked to pricing concessionality at the investment instrument level, but rather to the fact that the characteristics of these investments are not equally attractive to private investors based on their mandates and the universe of opportunities they have access to and therefore constitute their 'market'.

Since exit-mobilisation entails the sale of assets or the transfer of risk, the pricing of these exit-mobilisation transactions can act as a mechanism to address any concessionality gap between the original pricing of the instrument by the DFI and the return profile required to attract specific investors.

The cost of doing so to be borne by the DFI will vary according to specific investments and specific investors, and it may not be deemed acceptable, but it is important for the relevant stakeholders to keep in mind that any original pricing concessionality does not per se constitute an insurmountable barrier to exit-mobilisation.

6. PATHS TO EXIT-MOBILISATION

6.1. EXIT-MOBILISATION IN AFRICA: PUBLIC MARKETS AND OTHER OPPORTUNITIES

6.1.1. Accepting the Evidence

Exit-mobilisation, and MOBILIST more generally face specific headwinds in their application to the African continent. One of the most significant risks facing any capital mobilisation – and for that matter any fund raising – exercise is to dismiss investor feedback when it does not conform to the narrative underpinning the project. This risk is augmented in the sustainable development and impact investing context, as respondents to investor intentions surveys often find it politically expedient to make representations about future allocations to geographies or themes that prove more optimistic than what eventually transpires.

The outreach exercise conducted for this study does however present a clear picture, with readily identifiable challenges and opportunities.

The sample of UK based institutional investors interviewed made it very clear that Africa was not and is for the foreseeable future unlikely to be the subject of a standalone allocation. Any exposure is either anecdotal, linked to a specific theme or the result of an allocation to the broad emerging markets space. There are, in addition, persisting negative perceptions of Africa-specific risk, often focussed on financial crime. Whilst the specific focus of DFI investments should go a long way towards addressing these, this is a process that will require time as well as research, policy, and catalytic capital support of the nature proposed by the MOBILIST programme.

In comparison, African institutional investors generally have a mandate to invest locally as a priority and should therefore be a natural target audience for exit-mobilisation. Apart from the largest and most sophisticated funds such as the PIC, they do however display a very high level of risk aversion, in places informed by recent defaults. The generally conservative stance of their boards of trustees in addition means that there is little appetite for complex products. The relative simplicity of most public markets solutions could play an important role in this context.

The boom-and-bust cycle experienced by listed equity investors that started with the Economist's famed 'Africa Rising' headline has rattled the above categories of investors, but importantly delivered a painful first experience for the few OECD countries institutional investors that had entered the fray in its initial phase.

It would be prudent for any exit-mobilisation initiative to focus on sectors, instruments and structures that represent relatively straightforward propositions for investors.

Sectors that are experiencing excess demand globally, investments likely to be perceived as comparatively low-risk, and familiar structures should be prioritised to avoid failure or a sub-scale launch that might create a counter-productive precedent.

Finally, it would be strategically appropriate for MOBILIST to interact with and learn from other initiatives that seek to stimulate the mobilisation of private capital into the development space.

- US foundations have been conducting important work to better understand and support the mechanisms by which private capital might be mobilised. The recently launched Catalytic Capital Consortium – which is a joint effort to address the essential role of catalytic capital by three of the most active foundations in the space, namely the Rockefeller Foundation, the Omidyar Network, and the MacArthur Foundation – is an excellent example of this.

- Market infrastructure and business climate development initiatives should be harnessed to aid the development of Mobilist product paths and carry the message of exit-mobilisation into key jurisdictions. The previously mentioned FSD Africa and the Investment Climate Reform Facility (ICR) are two worthy examples. Publish What You Fund, which is currently working with DFIs to increase the transparency of their data, is another potentially key partner.
- Various DFI-driven initiatives must be engaged. Many European DFIs have created structures to mobilise private capital; with FMO, Bio, FinnFund, SIFEM, and DEG for example all achieving degrees of success. Several of these institutions have explored the use of listed structures. EDFI, as a force for DFI collaboration in this regard is important, not least as a potential platform for ensuring that the potential of listed structures is properly understood. There is a clear demand for technical content pertaining to private capital mobilisation amongst this constituency, and public markets solutions should be the focus of a collaborative information sharing drive.
- In the arena of blended finance relatively high-profile initiatives such as Convergence and the OECD's THK blended finance working group are actively exploring and recording entry pathways for private capital into development deals. Whilst MOBILIST's approach is clearly differentiated, there are areas of common relevance, ranging from data transparency to standardisation where synergies could be found.

6.1.2. Developing Market Infrastructure

Modern, functioning markets are a pre-requisite for exit-mobilisation. Necessary market infrastructure is self-evident in major financial centres and, as outlined earlier in this report, is in many instances increasingly advanced in East Africa. With this in mind it is essential to formulate a solid understanding of existing market infrastructure specificities so as to properly assess exit-mobilisation opportunities for their potential, as well as actual feasibility – including their likely time to market.

The most obvious difficulty to overcome is a lack of existing transactions that might act as functional examples to comfort market participants, including private investors, regulators, listing agents, and DFIs. Where examples of exit-mobilisation type transactions exist they are typically recent, not at significant scale, not conducted on African markets, and characterised by a relative lack of crucial data such as pricing. This state of affairs does not lend itself to organic market development.

As a consequence, it is recommended that a concerted effort should be made to enhance market infrastructure in likely exit-mobilisation market jurisdictions. Such endeavours should seek to address major information gaps for key market participants and in general should be prioritised according to market development level. Dual listing agreements, particularly where fungibility features are applicable, could help accelerate this process.

Table 6 below presents a non-exhaustive list of possible market infrastructure development actions that could be undertaken by the FCDO and other supportive development institutions in helping to overcome common market structure hurdles to investment activity, and in this instance to exit-mobilisation. In the table below suggested actions have been listed by the category of participant that they would assist.

Investors:	**Historical risk/reward, hedging:**
	• Facilitate greater access to the GEMs database
	• Encourage full disclosure of DFI performance data
	• Sponsor transparent benchmark Indices for relevant assets (e.g., infrastructure, PE funds)
	• Investigate currency hedging feasibility and cost (including forwards/options)
	• Conduct proxy analyses (fixed income and/or equity) to help manage illiquidity risk
Regulators:	**Risk and legal assessment:**
	• Analyse risk metrics (VaR) / comparative analysis with developed markets
	• Legal Support
Listing Agents:	**Profitability and regulatory analysis:**
	• Analysis of regulatory obligations (audit, custody, transfer & paying agents)
	• Draw up detailed fee schedules
DFIs:	**Capital impact and costs:**
	• Assist with assessments of capital treatment implications
	• Support direct and indirect transactional costs
	• Legal support

Table 6: Suggested market infrastructure development actions

UK capital markets policy

The global role that UK financial markets continue to play owes much to the liquidity they offer and the regulatory, business, and political framework that support them.

The LSE offers a choice of routes to market for UK and international companies, associated with various levels of regulation and including an established investment funds market. The depth and comprehensive nature of the associated regulation is a key factor for both UK and international investors.

Extending that influence is very much on the agenda and in November 2020, "the Chancellor outlined new proposals to support sustainable financial flows and extend the UK's global leadership in green finance ahead of hosting COP26"[33].

The UK Government is also undertaking a series of reviews to ensure regulation enhances the UK's attractiveness as a global financial hub which may be a boost to any future mobilisation agenda. This includes a consultation on changes to the listing regime and a review of requirements on free float, dual class share structures, premium listings track records thresholds, prospectus rules, as well dual listing requirements.

UK markets are accessible to African actors and there are no regulatory barriers to either African entities listing on London markets or African investors investing through LSE listed instruments.

6.1.3. Solving for Scalability

Scale is a desirable feature for most investment vehicles and instruments but is specifically relevant to the public markets agenda of MOBILIST. For exit-mobilisation initiatives to achieve this, it is necessary to solve for the highest possible common intersection point between the supply of a coherent portfolio of DFI assets (or the size of an individual stake or instrument) and the demand for exposure. To create the optimal conditions for secondary market liquidity, it is in addition necessary for the latter to be sourced from the widest possible audience of investors.

33 Source: UK Government, https://www.gov.uk/government/news/chancellor-sets-out-ambition-for-future-of-uk-financial-services

Supply

It is therefore, in a first instance, important to ensure that the pool of DFI assets or the individual DFI investments to be exited is sufficiently sizeable. This might mean that only the largest DFIs are able to provide the underlying assets, or alternatively that several DFIs should contribute to the exit-mobilisation pool. These pools should as far as possible be coherent as investors often take a dim view of investment vehicles lacking uniformity, if only because these fail to fit neatly within one of their investment buckets.

Demand

When introducing a new theme or asset class, it is prudent to address as wide an investor base as possible to maximise the probability of a successful launch. Careful consideration should for example be given to regulatory frameworks, multi-currency issues and dual listings. Reaching critical mass can in addition be difficult for first time issues, and any participation by the issuing DFI or other official sector sponsors would be a significant asset. Scale is a virtuous circle, and vehicles presented as having the potential to reach it will be deemed suitable by a wider investor base, as the minimum-size thresholds of larger institutions are met.

RENEWABLE ENERGY GENERATION MAPPED DIRECT COMMITMENTS BREAKDOWN BY SUB-SECTOR

SOLAR	41%
HYDRO	31%
WIND	16%
GEOTHERMAL	11%
BIOMASS	0.7%

Figure 22: Renewable energy generation – Mapped direct commitments breakdown by sub-sector

6.2. RENEWABLE ENERGY

6.2.1. Supply

Renewable energy generation accounts for 49% of direct commitments catalogued for the purpose of this study made to the Energy & Extractive sector. Loans account for the bulk of these, or USD 5.2 billion worth of commitments, which in the context of African DFI investment is significant. Conversations with DFIs in addition suggest mounting policy pressure translates into a growing focus on the sector, which bodes well for future deployments.

Two European DFIs provide useful examples in this regard; Norfund reports 48% of its assets as being 'clean energy' investments as of the end of 2019 and FMO deems 34% of its investments to be green. More broadly, the DFI focus on climate change related infrastructure investments is well established.

Power generation projects are, as illustrated earlier in this report, most often associated with the provision of guarantees and other risk-mitigation features, all of which should enhance the lure of exit-mobilisation opportunities from the point of view of prospective investors. It is also worth noting that where loan tenors go beyond the construction phase, post-construction exit-mobilisation was identified by institutional investor respondents as attractive.

As discussed earlier, the number of DFIs participating in the financing of some individual projects suggests that either headroom and exposure limitations or the desire to 'plant the flag' might well be key motivations, which in turn suggest exit-mobilisation should be desirable from the DFI standpoint in this sector.

6.2.2. Demand

There exists a wealth of research showcasing the growing investor appetite for green investments in general and renewable energy assets in particular. This secular trend is well documented. The LSE renewable energy investment trusts sector's success additionally demonstrates the relevance of and appetite for this structure as applied to this specific theme.

It is helpful to note that appetite for renewable energy access in addition straddles the investor constituencies engaged as part of the outreach conducted for this study. African institutional investors expressed an interest in the sector either in the context of their sustainability agenda, or as a result of the increasing share of renewables in their country's power supply, or both. UK-based and international institutional investors have a demonstrated appetite for renewable energy assets, and the best opportunity to offer them exposure to the African continent may well rest in this sector where there is both increased familiarity and excess demand. It is also worth noting that wealth management groups and the retail investor segment have displayed high levels of support for the sector. Preferences for debt or equity exposure to the theme vary from one category to another. Although the bulk of DFI exposure is on the debt side, there are equity opportunities to explore.

6.2.3. Paths to Exit-Mobilisation

CEICs

As illustrated below, the LSE renewable energy CEIC sector's success demonstrates the relevance of and appetite for this structure as applied to this specific theme. The sector now accounts for well over GBP 10 billion in assets and its constituents typically trade at a premium to NAV. An African renewable energy investment trust could therefore represent the shortest path to exit-mobilisation since the geographical mandate would be the main deviation from a tried and tested blueprint. Such a CEIC would acquire a portfolio of assets from one or more DFIs but given its quasi-permanent capital nature would have a mandate to source additional investments once the maturity of the original batch is reached.

LSE RENEWABLES ANALYSIS

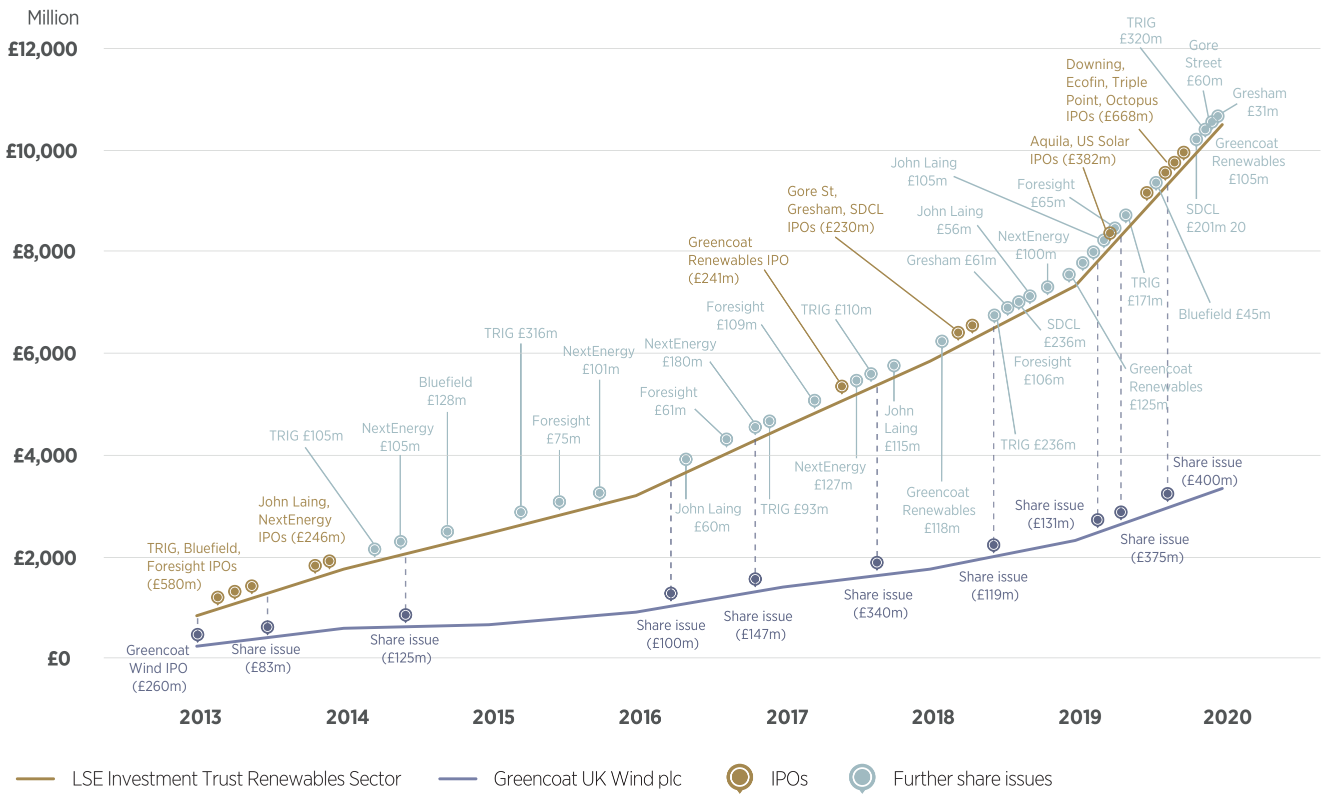


Figure 23: The LSE renewable energy CEIC sector (source: Eighteen East Capital)

A DFI accepting full or partial payment in the CEIC's shares would make it easier for the CEIC to reach critical scale at the IPO stage. This retained exposure could be divested over time through the secondary market, potentially coinciding with a c-share issue, or retained as a long-term holding.

Cornerstone investments from official sector entities, such as the one made by BIS in the case of the Greencoat UK Wind IPO would send a strong message to the market and once again help maximise the launch size.

This could take an underwriting form, whereby the investment only takes place should a specific size threshold not be reached.

Where possible, there is the opportunity for the DFI or its asset management arm to play the role of investment manager of the CEIC or that of the investment adviser to the CEIC's board, thereby both protecting the adherence to its impact mandate and generating a source of income.

As discussed, the bulk of DFI direct commitments to the renewable energy sector are in the form of loans, and a debt focussed CEIC would therefore be a likely candidate. The search for yield in a low interest rate macro-environment reinforces this thinking.

There is however also potentially the opportunity to list existing private funds in the sector. This would present an exit-mobilisation opportunity for the DFIs, which would effectively swap illiquid LP stakes for listed shares they can dispose of over time, but also an opportunity for the general partners to manage a long-term pool of capital associated with reinvestment cycles.

Green CLOs

Portfolios of loans could be securitised, using either true-sale or synthetic securitisation techniques, with the securitisation SPV in turn issuing green bonds to investors. A single debt tranche re-securitisation could be used, with the issuing DFI retaining the equity tranche, a development agency issuing a guarantee or the SPV using DFI debt over-collateralisation to achieve credit enhancement. A CRA could in addition be approached to rate the green bonds, both from a credit quality and a green certification standpoint. Much has been written about the potential growth of the Green CLOs market, and it is noteworthy that Standards & Poor's published a note titled 'The Future Looks Green for CLOs'[34] around 2018's COP 24. Whilst such a Green CLO structure would not be actively managed, and would not have a re-investment feature, the issuing DFI could potentially act as CLO manager to ensure impact continuity.

Such a Green CLO programme could have follow-on transactions allowing for scale over time, but it might still be beneficial to pool loans from a number of DFIs to achieve scale. It is worth keeping in mind that DFIs often co-invest in the same loans, making this exercise more straightforward.

Although it would fail to fulfil the exit component of exit-mobilisation, a DFI could of course also elect to issue a covered green bond to fund its operations in a cost-effective fashion.

34 https://www.spglobal.com/_assets/documents/ratings/research/cop24-special-edition-shining-a-light-on-climate-finance.pdf

6.3. FINANCIAL INSTITUTIONS

6.3.1. Supply

Financial institutions received USD 15 billion, or 42.6% of the direct DFI commitments mapped for the purpose of this study. Of these, 96% were in the form of loans.

Not only are the USD 443 million in direct equity transactions not negligible, but it is important to keep in mind that the mapping of commitments does not capture Investments made prior to 1/1/2010, and the 'Zoom in on East Africa' chapter of this study shows that DFIs hold equity stakes in African financial institutions, directly or indirectly, above and beyond this amount. Unlike loans and private equity funds, the non-self-liquidating nature of direct equity stakes indeed leads to an accumulation effect. In the context of MOBILIST and its exit-mobilisation workstream, it is interesting to note that many of these stakes are held in the form of listed equity. There are also special situations, such as the AfricInvest SPV-intermediated holding in Britam, and the Arise holding company.

A significant portion of the mapped loan commitments made by DFIs to African financial institutions are in the form of credit facilities which can be drawn over time, rather than term loans.

This means that transferability to pooled vehicles is potentially more problematic. As discussed above, facilities are generally extended in hard currency, for a medium to long term tenor, at a floating rate composed of a reference interest rate (e.g. 6-month USD LIBOR) and a margin.

6.3.2. Demand

The regulated status of financial institutions and the financial management rigor the associated supervision brings about, as well as the fact that they more commonly fall within the scope of the CRAs should in theory make financial institutions the low hanging fruits of exit-mobilisation.

Loans to financial institutions form a significant part of some of the more successful private capital mobilisation initiatives, ranging from Room2Run to the FMO IM funds and the IFC's MCPP financial institutions, credit insurance-based window. The feedback collected from UK-based institutional investors for the purpose of this study does not however provide evidence of clear appetite for the sector at this point in time. One respondent in particular highlighted that financial institutions are reluctant to add exposure to their own sector, although the dynamics of SME lending in Africa can objectively be said to be subject to very different dynamics to those affecting them.

The picture is more encouraging where African institutional investors are concerned, and the need for diversification opportunities, recognisable corporate entities, and the track record of many of the continent's banks are all contributing factors to potential demand. The reality is of course that many of the financial institutions DFIs lend to are listed on their local stock exchange, and as such most local institutional investors already hold equity exposure.

There are nevertheless significant headwinds in places, and two high-profile bank defaults in Kenya have for example for a time all but put a halt on bond issuance in the country.

6.3.3. Paths to Exit-Mobilisation

Divesting Listed Holdings

There might well be legitimate strategic reasoning behind DFIs holding large equity stakes in some of the largest publicly listed financial institutions on the African continent. Notwithstanding any difference in the class of shares they might hold in specific instances, they do however invest pari passu with local institutional, local retail and international investors alike. The level of demand for individual stocks may of course vary according to market-wide or idiosyncratic factors, but the simple fact is that there must be a price at which the sale of these holdings constitutes the most straightforward, if perhaps not the most exhilarating, path to exit-mobilisation at scale.

Synthetic CLOs

The predominant use of credit facilities as a lending instrument means that synthetic securitisation techniques are more appropriate. Credit insurance, as used by the IFC's MCPP is itself not fit to target a wide audience of investors. A tranche of a portfolio of drawn loans to financial institutions could be the subject of a synthetic securitisation via an SPV that issues a single tranche of debt. Should this be attempted in the local market, and with the risk-aversion and limited appetite for complex structure on the part of local investors front of mind, the securitised tranche could be selected to build-in a first loss exposure for the DFI, and an equity tranche in the SPV could be held by either the DFI or a development agency. Any guarantee would in addition be useful, and the partial credit guarantee extended by PIDG's GuarantCo to the Acorn notes issue is a useful precedent. Whilst there is no suggestion that blended finance is a si ne qua non condition of exit mobilisation, it might be necessary to jump start local debt markets where they are not functioning effectively. The complexity inherent to this model would at this stage make it difficult to implement in local markets given the feedback received from African investors.

Listing Holding Companies: Arise B.V.

Arise B.V. is an investment company jointly held by Norfund/Norfinance (48%), FMO (27%) and Rabobank (25%). The entity reports holding a portfolio of ten stakes in financial institutions, seven of which are listed, across nine countries in sub-Saharan Africa, the result of the consolidation of some of the holdings of its shareholders. With offices in Cape Town and Amsterdam, its website suggests it employs twenty individuals.

Arise B.V.'s raison d'être and the long-term vision of its DFI owners should be the subject of further research, but it presents the student of exit-mobilisation with a very interesting case study.

Listing such a professionally managed, diversified portfolio of holdings in the sector on a major stock exchange (e.g. Euronext Amsterdam or JSE), potentially envisaging a dual listing could represent an attractive opportunity for international investors to gain exposure to the sector through a single counter, but also for the incumbent shareholders to gradually recycle their capital.

7. POLICY IMPLICATIONS

7.1. STRATEGIC CLARITY

7.1.1. Active Ownership

Financial institutions are ultimately profit driven entities whose governance is designed to ensure their shareholders' interests are prioritised. DFIs were in contrast in most cases primarily designed as instruments of policy.

Whilst it is evidently not the purpose of this study to direct policy, it is important to stress that to effect change, clear strategic direction must be given to the institutions tasked with the implementation of development finance policy and compliance must be controlled through active ownership.

Should exit-mobilisation form part of a development finance strategy, several implications may affect the performance and the management of the institutions involved. These implications would need to fully be understood by their governance and ownership structures, and their management reassured that they have a corresponding mandate.

7.1.2. Financial Performance, Price and Resources

Exit-mobilisation may have an impact on the financial performance of DFIs. Notwithstanding the price at which transactions are made, the time and resources it will take the 'exiting' DFI to redeploy the freed-up capital is likely to have a direct impact on its profitability, although synthetic securitisation techniques differ from this standpoint. DFI shareholders should therefore make it clear to DFI management that they are conscious of and prepared for this eventuality.

The price at which DFI assets are sold to private sector actors is a key component of exit-mobilisation. It can, for example, be set to adjust the expected returns of specific loans to investor requirements, resulting in a de facto subsidy akin to those integral to the blended finance model. In the case of private equity funds, there is a well-documented reluctance to sell below NAV, even where the DFI is in fact applying a haircut to that NAV for its own valuation purposes. Clear guidelines should therefore be put in place to define what the acceptable terms of exit-mobilisation are. These guidelines should reflect differences between geographies, sectors, and instruments.

DFIs are in some instances constrained by the limited human resources at their disposal. They are focussed on origination and deployment, and exit-mobilisation is likely to further stretch their capacity. The need to bring additional resources to bear may further dent their profitability.

7.1.3. Conflicting Objectives

The focus on yearly deployment figures in their public reporting as well as private conversations with DFI management and teams suggest that absolute deployment objectives are key performance indicators (KPIs).

The ability to recycle capital that is inherent to exit-mobilisation should allow DFIs to deploy more capital over the same period of time.

It is however important that the manner in which deployment figures are calculated should take a cumulative approach, rather than only recognise those investments held on the DFI's balance sheet at a given point in time. In other words, it is the origination component of deployment that should be the focus rather than whose capital is used over the duration of individual investments.

7.1.4. Messaging

Another important concept is the messaging dimension assigned to exit-mobilisation transactions. The language of 'support' for specific sectors, geographies and populations is a prominent feature of the DFI narrative. Conversations conducted with DFI teams about exit-mobilisation reveal that there is a very real concern that the sale of assets may be construed as the withdrawal of such support for the underlying companies, fund managers or projects. There should consequently be a very clear communication strategy around exit-mobilisation, explaining that any capital thus freed-up will be recycled into new and additional projects, and that the mobilisation of new sources of capital not only increases the overall quantum of capital available to these projects, but further enhances the sustainability of their sources of funding through diversification.

7.2. POLICY STREAMS

7.2.1. Transparency

The lack of publicly available data pertaining to DFI investments continues to act as a major stumbling block to private capital mobilisation efforts. The fact that there is real concern amongst practitioners that the publication of data may either jeopardize such efforts, should the performance of DFI assets be deemed inadequate, or on the contrary cause the role of DFIs to be reconsidered is a poorly concealed secret. The need to protect commercial confidentiality is invoked, but it stands to reason that entities that are in absolute need of DFI funding to operate would be unlikely to stand in the way of transparency initiatives. The fact is that DFI funded financial institutions for example routinely publish more granular information about such funding than the DFIs themselves.

Information is the cornerstone of all markets. It is crucial to drive for more transparency if exit-mobilisation is to be effective. This is particularly relevant to the African context as there exist fewer alternative sources of data.

There should be no suggestion that 'disappointing' data might act as a hurdle to private sector investment, if only because the absence of any data will ensure it does not materialise.

Building and maintaining a coherent and robust financial performance database is however a costly endeavour. It is possible that the reluctance to provide data transparency is in part linked to the fact that such data is not always available in the required format or quality. Financial institutions maintain data management operations because of both regulatory obligations and competitivity motivations. In a context of scarce resources and absent incentives, at least the smaller DFIs might struggle to do so.

It is incumbent on policy makers to ensure this is not a capacity issue. An academic institution could, for example, be funded to mine the data at each DFI and maintain a suitably anonymised financial performance database. The University of Oxford Saïd Business School for example has the capacity to do so for private equity funds. Given their inherent transparency, an increased recourse to public markets instruments would leverage on such initiatives, ensuring they benefit the wider market.

7.2.2. Standardisation

Public capital markets are based on standardised instruments. The growth of the derivatives market under the auspices of ISDA provides recent proof of the importance of standardised legal documentation, even in a highly competitive environment. The MOBILIST programme generally and exit-mobilisation specifically would therefore benefit greatly from a higher level of standardisation in the instruments used by DFIs. Too often is flexibility used as a pretext for unnecessary divergence and complexity. Not only would simplification and standardisation make exit-mobilisation transactions more straightforward, but they would also reduce the costs associated with the original investments, enhancing their returns and consequently their attractiveness.

The relative coherence of the objectives of the small club of DFIs, their collaborative culture as well as their common geographical and sectoral mandates should make standardisation far easier than it was to bring together competing financial institutions in the context of global derivatives markets.

Standardisation will however again require policy makers not only to task DFIs with its implementation, but also to ensure that the transposition of their own policy decisions to the development finance space does not contribute to future divergence.

7.2.3. Incentivisation

Exiting

A key objective of the MOBILIST programme should be to create the correct incentives to ensure that the actors of exit-mobilisation are appropriately motivated.

Conversations held with DFI teams and management, initiatives managed by industry stakeholders, feedback from private investors, and engagement with DFIs all provide evidence of the same core issue: there is a need for better alignment of DFI incentives and private capital mobilisation objectives.

Absolute deployment objectives coupled with limited pipeline within the narrow 'investable' band defined by prudently set investment criteria mean that private capital mobilisation risks being perceived as a competing force rather than as a complementary resource. Profitability-linked incentives, sometimes reinforced by the drive to build a compelling track record for asset management-based mobilisation initiatives, can as discussed above be construed as antinomic to exit-mobilisation

DFI teams have for decades been at the coalface of development finance and have been creating markets where none existed with limited resources in challenging frontier environments. In the absence of clear objectives and coherent incentives being defined by their governmental owners, it can come as no surprise that the preservation of the status quo is the first response to externally driven agendas.

Building incentives based on balance sheet optimisation, capital velocity and non-DFI mobilisation ratios into the DFI business model should be the corollary of the exit-mobilisation agenda.

Mobilising

Fiscal stimulus

The field of blended finance is the concrete manifestation of the acknowledgement that shifting investment behaviours towards alignment with sustainable development objectives may for a time require some measure of subsidisation.

In line with the reliance of the development finance sector on one-off deals and bespoke structures, blended finance to date has focussed on the application of multi-layered structures to individual transactions. Beyond the financial cost implications and opportunity cost in terms of scalability of this model, it further presents a risk of market distortion as the private entities benefiting from such subsidies may gain an unfair advantage vis à vis their competitors.

It would be useful for MOBILIST to establish whether the tried and tested incentivisation of investments towards targeted sectors by way of fiscal stimuli could be applied to the development finance sector. Instead of spending public funds to entice investors to a specific instrument, this would offer an incentive to all investments satisfying specific criteria. The reduction in tax receipts could in theory be justified by the substitution of private capital for the public funds deployed by DFIs. Whilst the tax relief extended to private investors would reduce tax income, there would indeed be a lower need to recapitalise DFIs.

Regulatory stimulus

In line with existing and future taxonomy initiatives, MOBILIST could advocate for the advent of reporting requirements in the context of developing countries. Institutional investors could, for example, be asked to report on their exposure to geographies and sectors singled out as strategic priorities by policy makers. This could have the mechanical effect of gradually shifting investor focus towards Africa, which is at this stage not the object of a standalone allocation by UK institutional investors. Best practice recommendations as an alternative to fully-fledged regulatory obligations and reporting requirements could have a significant impact. For example, if boards of directors, CIO offices and investment consultants were to regularly assess their overall involvement in development finance, it would create awareness and could over time conceivably become a commercially differentiating factor for institutional investors.

An oft heard argument against investing on the African continent is that, given the limited capacity for its markets to absorb large amounts, it would not 'move the needle' in the context of large institutional portfolios. It follows that the risks associated with such an inconsequential exposure would present no threat to institutional investors. An allocation to African assets across UK institutional portfolios, no matter how small, could in contrast have a significant impact on the economic development of the continent. It might consequently be opportune for MOBILIST to explore the potential for a 'London Agreement' encouraging institutional investors to commit to a minimum allocation to African assets, some of which could be sourced through exit-mobilisation.

7.3. EXIT-MOBILISATION & LOCAL CAPITAL MARKETS

There is no doubt that the challenges of sustainable development necessitate a quantum of capital that only OECD countries institutional investors can provide. It is equally evident however that the objective must eventually be for local investors across Africa to have significant ownership of local assets and exposure to their own economic growth. It is in addition readily observable that institutional investors have a different perception of the risks associated with their local capital markets, and a higher demand for exposure thereto than foreign investors, a pattern reinforced by regulatory frameworks in many African countries.

Whilst the mobilisation of international pools of capital will be necessary to achieve sustainable development on the continent, local African capital markets may provide a path of least resistance in the short term. MOBILIST presents an opportunity to increase the focus of private capital mobilisation efforts towards local capital markets development and local institutional investors engagement. Collaboration between local capital market authorities and exchanges and their UK counterparts has already delivered modern market infrastructure.

The high level of risk aversion of many African institutional investors should not be under-estimated and technical advisory engagement with pension regulators, trustees and fund managers could be used in conjunction with the de-risking instruments successfully deployed by the likes of PIDG's GuarantCo. It is important to keep in mind that African governments rely on the outsized allocations to government securities to fund their expenditure, and alternative solutions should be identified if a shift towards risk assets is to materialise. In the specific context of exit-mobilisation, the hard currency denomination of DFI investments creates an additional layer of complexity, as African institutional investors typically have limited hard currency liabilities to match. Hedging solutions would therefore need to be applied, for example through existing platforms such as TCX.

Dual listings should be envisaged to bring to bear the liquidity, technology, and governance of leading exchanges such as the LSE, delivering more attractive valuations for exiting DFIs and combining local investment status for African investors and a familiar access point for their international counterparts. Building on the already considerable framework of fast-track agreements linking the LSE to African exchanges would in this regard be very useful.

The mobilisation of African private capital does not only potentially represent an opportunity to leverage off the crucial work DFIs continue to deliver, but would ensure that African populations, through their savings, pension plans and insurance cover, benefit from their own economic growth.

8. CONCLUSION

The mobilisation of private capital at scale to meet the world's development needs is a key policy objective of the MOBILIST programme. It is an objective based on the awareness that global development challenges, as captured by the UN's SDGs, cannot be overcome only through the deployment of relatively scarce official development assistance. DFIs can and must play an important role in leveraging their capacity and expertise to provide entry points and conduits for private capital flows at scale. Exit-mobilisation should be viewed as a fundamental method by which increased private sector participation can occur, accelerated where possible by a focus on public markets solutions.

Many of the ingredients of exit-mobilisation are already in existence in the African context. DFIs hold coherent and sizeable portfolios of assets, a significant part of which is focussed on sectors and themes aligned with investor interest, and that, where African investors are concerned, correspond to a documented need for diversified exposure to the continent's economic growth.

An array of tried and tested public markets instruments and structures relevant to exit-mobilisation can be readily identified, and exchanges, both locally and globally can provide the required market infrastructure and regulatory framework.

Whilst there is ample opportunity for the MOBILIST initiative to drive interventions conducive to an accelerated process, the main policy drive needs to look beyond the technical and demand aspects of exit-mobilisation. Exit-mobilisation is predicated on a significant shift in the modus operandi of the development finance system. To bring about its advent, it will be necessary for the institutions who control DFIs to issue them with clear strategic objectives and directives, establish corresponding incentives and governance mechanisms, and equip them with the mandates and the means they will require to achieve system change and accelerate the global drive towards sustainable development.

The complexity of such an undertaking is well understood, and change is unlikely to occur simultaneously across the sector. There is a growing recognition that it is however both necessary and inevitable, and DFIs are closely monitoring each other's mobilisation efforts. Should one institution display leadership and take a decisive step towards exit-mobilisation, others might find it increasingly difficult to defend the status quo.

Building on its core principles of commercial viability, replicability, scalability, additionality and feasibility, MOBILIST provides DFIs with a useful mechanism through which they can test new policy directions with the support of UK Government's FCDO.

The positive response to the cornerstone MOBILIST Infrastructure Competition provides initial evidence of the market's readiness for listed products-based mobilisation. Exit-mobilisation is in turn an opportunity to harness the full potential of public capital markets, and one DFIs are uniquely positioned to seize.

EIGHTEEN EAST

For more information:
Please contact Eighteen East Capital
at info@18eastcapital.com with any
comments or questions about this report.