MARKET STUDY REPORT | OCT 2019

Private Equity Investing for Pension Funds in East Africa

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Market Study on Private Equity Investing for Pension Funds in East Africa

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MARKET STUDY REPORT

Private Equity Investing for Pension Funds in East Africa

OCTOBER 2019

Foreword

Economic empowerment and wealth generation for a country's citizens are fundamental to that country's progressive development. Wealth generation not only allows us to provide for younger generations, but also takes care of retiring and ageing citizens.

As part of Kenya's Retirement Benefits Authority (RBA) vision to ensure an inclusive, secure and growing retirement benefits sector, we continue to work with the market to identify growth opportunities that safeguard the retirement benefits of the Kenyan people. For this, we have developed – and continue innovation in their making – accessible products that generate investment value, further enhancing the sector's growth, while at the same time providing impact to the economy.

As part of the RBA's 2019-2024 strategic plan, we propose innovative ways to mobilise long-term savings to finance investment in the 'Big Four Agenda', which is part of the Government of Kenya's Medium-Term III plans. In this regard, we have identified private equity as one way that our pension schemes could participate.

'Private equity and venture capital' is one of the investment asset classes available for our members in Kenya. Since 2016, the RBA has allowed its pension schemes to invest up to 10% of their assets under management in this class, with investment to date totalling 0.07%. There is, therefore, still ample room for pension schemes to invest more funds in the asset class. The private equity sector exposes pension schemes to a variety of sectors – including those covered in the Big 4 agenda – to expand the scheme's range for portfolio earnings.

Knowledge and capacity enforcement remains a key consideration for RBA as we encourage our pension schemes to increase their exposure to private equity. The undertaking by EAVCA, FSD Africa and the World Bank through the IFC, to generate this Market Study Report is welcome, as we seek to bridge the knowledge gap that will help investors with the right information to make investment decisions into the asset class. Information provides a tool that empowers investment and charts the course for wealth generation and economic progression.

I thus applaud and congratulate the involved parties for the detailed findings generated here and look forward to building on this knowledge to drive growth of investment in private equity and consequently in the retirement industry.

Nzomo Mutuku, MBS
Chief Executive Officer,
Retirement Benefits Authority Kenya

Acknowledgements

The publishers would like to acknowledge the following institutions, organisations and individuals who contributed their valuable knowledge to this report.

In Kenya: the Capital Markets Authority, the Retirement Benefits Authority, the Association of Investment Managers and the Association of Retirement Benefit Schemes. In addition, Limited Partners who provided valuable insights include: the Central Bank of Kenya Pension Fund, the Banki Kuu Pension Scheme 2012, the Local Authorities Pension Trust, the CPF Fund, the IPP Fund, the JKUAT Staff Retirement Benefits Scheme, the KenGen Staff Retirement Benefits Scheme and KenGen DC Scheme 2012, the Kenya Airways Staff Provident Fund, the Kenyatta National Hospital Superannuation Scheme, the Kenya Petroleum Refineries DC Pension Fund, the KMFRI Staff Pension Scheme, the National Social Security Fund, the Standard Chartered Bank Pension Fund and the TelPosta Pension Scheme.

We also thank the Rwanda Social Security Board, the Uganda National Social Security Fund, the Uganda Retirement Regulatory Board and the Umeme Limited Staff Retirement Benefits Scheme, the latter also in Uganda.

In addition, our gratitude goes to all General Partners who provided valuable insights and to industry professionals whose expertise and insights were sought, including the RisCura team.

Finally, we would like to convey our appreciation to the East Africa Venture Capital Association, the FSD Africa Financial Markets and Communications team and the IFC Private Equity team, without whom this publication would not have been possible.

Acronyms & Abbreviations

AVCA	Africa Venture Capital Association
AUM	Assets Under Management
CMA	Capital Markets Authority (Kenya)
CSR	Corporate Social Responsibility
DB	Defined Benefit
DC	Defined Contribution
DFI	Development Finance Institutions
EAVCA	East African Venture Capital Association
ESG	Environmental, Social and Governance
EY	Ernst & Young
FSDA	Financial Sector Deepening Africa
FOF	Fund-of-Funds
GDP	Gross Domestic Product
GIPS	Global Investment Performance Standards
IFC	International Finance Corporation
ILPA	Institutional Limited Partners Association
IPEV	International Private Equity and Venture Capital Valuation Guidelines
IPS	Investment Policy Statement
IRR	Internal Rate of Return
IMA	Investment Management Agreement
GP	General Partner
KES	Kenya Shillings
LP	Limited Partner
LPA	Limited Partnership Agreement
LPAC	Limited Partner Advisory Committee
PE	Private Equity
RBA	Retirement Benefits Authority
RSA	Republic of South Africa
SAA	Strategic Asset Allocation
SRI	Socially Responsible Investing
UNPRI	The United Nations-supported Principles for Responsible Investment
URBRA	Uganda Retirement Benefits Regulatory Authority
US$	United States Dollars
VC	Venture Capital

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Executive Summary

Across the world pension funds play a catalytic role in financial market deepening, owing to the large pools of capital held and their long-term investment horizon. They serve as the necessary patient capital that allows for scale in developing sectors and economies.

Globally, private equity is one of the sectors that has grown as a result of support from pension funds, with the typical 10-year fund tenure matching the long-term investment outlook for pension funds. However, in East Africa, despite explicit allowance by regulatory guidelines for investments in private equity, allocation by pension funds remains muted. The bulk of private equity funds is sourced from development finance institutions, which account for almost 70% of funds held by private equity firms.

As the private equity industry matures in East Africa, there is a need to systematically engage pension funds to enable them to play their rightful role in driving growth of the private equity industry. The benefit of private equity investment to pension funds relates not only to diversification but also to exposure to the real economy. Private equity funds have been known to invest in sectors such as health, sustainable energy, education and consumer/retail. The outcomes of such investments include: increased incomes and jobs, access to basic services and sustainable finance. Investment by pension funds in private equity will therefore enable them to actively participate in growth sectors of the real economy.

In 2018, East Africa Venture Capital Association (EAVCA), Financial Sector Deepening Africa (FSD Africa) and the International Finance Corporation (IFC) partnered under an initiative aimed at spurring investment by pension funds into private equity.

THE INITIATIVE INVOLVED:

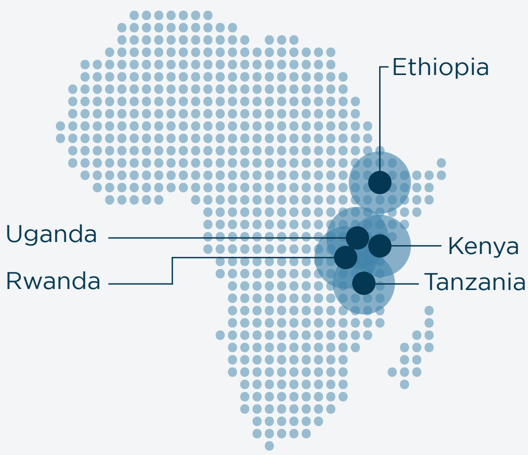
A SERIES OF WORKSHOPS OR CAPACITY-BUILDING SESSIONS

A MARKET ASSESSMENT

DEVELOPMENT OF A PRIVATE EQUITY INVESTMENT GUIDE FOR PENSION FUNDS

THIS REPORT PRESENTS THE FINDINGS OF THE MARKET ASSESSMENT.

STUDY COVERAGE:



ACROSS ALL FOUR COUNTRIES:

Private equity is an allowable asset class for investment, with the respective countries' industry regulators providing guidelines on allowable investments in private equity.

The study also finds that reasons behind slow uptake of private equity by pension funds include: knowledge gap on both the pension fund and regulatory side; and absence of regulatory oversight of Private Equity Fund Managers by local regulators.

The Market Study gives context to some of the parameters that influence the investment decision, such as the size of the funds held by pension funds in East Africa; this has a direct influence on their decision to allocate into the private equity asset class, which will normally have a minimum threshold for investments.

Beyond the size of the funds, the risk perception attributed to private equity investments also heavily influences a pension fund's decision to allocate to private equity. The study notes that the assessment of private equity risk is within a context of a fixed and considerably short time frame of less than 60 months, which does not match the long-term nature of value generation in private equity. In engaging stakeholders for the study, it was clear that there is a need to develop an appreciation of the asset that matches the reality of the industry, in order to correctly apportion risk.

The Market Study further finds that access to the real economy is a compelling reason why the pension schemes in each of these countries should be looking to be active and meaningful Limited Partners of private equity funds. In doing so, the pension schemes will be exposing the retirement savings of their members to differentiated investment opportunities within their own countries and the East African region.

The findings in this Market Study informed the learning areas and critical points that have been addressed in the capacity-building sessions and the East Africa Private Equity Investment Guide, a follow-on publication and final outcome of this industry engagement initiative. The Investment Guide will be a reference tool for decision guidance to be used by East African pension scheme trustees as they contemplate investing in private equity.

In conclusion, the partnering firms EAVCA, FSD Africa and IFC acknowledge and thank the RisCura team for the detailed market engagement, information gathering and documentation that resulted in this report and the subsequent Private Equity Investment Guide.

1 Introduction

1.1 Background

The East Africa Venture Capital Association (EAVCA), Financial Sector Deepening Africa (FSD Africa) and the International Finance Corporation (IFC) (the partners), contracted RisCura to engage in a capacity-building initiative that culminated in the development of an investment guide for limited partners in East Africa. To obtain an investment guide that accurately captures the needs of the East Africa market, the partners sanctioned a market study as the first phase of a wider programme of initiatives around creating awareness of private equity as an eligible and alternative asset class for investment by East African pension schemes. The findings of the market study are presented in this report.

1.2 Purpose of the Market Study Report

The broad purpose of this Market Study Report (Report) is to:

1. Conduct an assessment of secondary data to set the context and determine the perception of private equity investing amongst local stakeholders

2. Compile and collate the findings and proffer recommendations from such findings, from a market survey of specific stakeholders to the private equity industry in East Africa, namely:

- PENSION FUNDS (Limited Partners)
- PRIVATE EQUITY FIRMS/ PRACTITIONERS (General Partners)
- PENSIONS AND SAVINGS AND CAPITAL MARKET REGULATORY BODIES.

The findings of the Report and recommendations are important for:

- Better perception of where there may be gaps in understanding private equity as an asset class, that serve as limitations to an increased allocation by East African pension schemes to the asset class.
- Establishing the (current) general level of understanding of key aspects of private equity investing by East African pension schemes, which include (but are not limited to), governance, and commercial and legal concepts used in private equity investing.

This Report informed learning areas for the Investment Guide. The Investment Guide will aid as a capacity-building and decision tool to be used by East African pension scheme trustees as they contemplate investing in private equity.

1.3 Scope of the Report

The objective of the study is to increase the pace of adoption of private equity as an asset class by East African pension schemes.

The recommendations of the Report focus on increasing the capacity of East African pension scheme trustees, as fiduciaries, as they contemplate investing in the asset class.

The Report analyses primary data from the survey to get a sense of the level of understanding of the asset class. The Report also provides a high-level appreciation of the pension framework in East Africa. This framework is important to enable the authors to formulate actionable recommendations to increase the pace of adoption of private equity as an asset class by East African pension schemes. This context also sheds some light as to why (to date), the pace of adoption by East African pension funds of private equity as an asset class has been slow.

Tasks and responsibilities undertaken in the compilation of this Report included:

1. Desktop review of current and existing research into the allocation by East African pension schemes (broadly) and specifically to private equity as an asset class.
2. Expounding on narratives that may have historically limited the level of understanding and, in turn, the asset allocation decision to private equity as an asset class by East African pension schemes.
3. An appreciation of current investment policy design and the investment decision-making framework(s), as they relate to private equity allocations by East African pension schemes.
4. Proposal of focus areas and further investigation that would be beneficial for capacity-building on private equity investing for East African pension scheme trustees.

1.4 Methodology

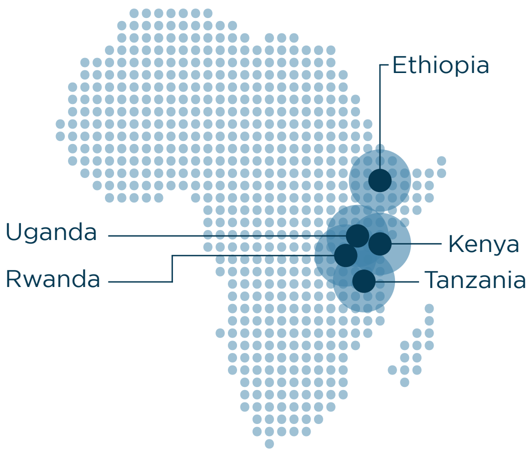
RisCura approached the market assessment and subsequent development of the Report in the following stages:

- Review of applicable reference literature
- Consultation with industry experts and practitioners
- Formulation and implementation of the market survey questionnaires
- Drafting of the Market Study Report
- Report finalisation

2 The East African Limited Partner

2.1 The East African pensions sector

Within the context of this Report, 'East Africa' was framed as the five countries within which the EAVCA has a mandate, namely:



Implicitly, given that the primary members of EAVCA are General Partners of private equity and venture capital funds deploying capital in East Africa, the pension schemes in each of the five countries are relevant to this Report. The pension schemes in these five countries are potential Limited Partners. In addition, the economic activity that the General Partners are inducing by making investments in each of these countries is representative of the investment and economic activity on the door-step of these pension schemes. This access to the real economy is a compelling reason why the pension schemes in each of these countries should look to be active and meaningful Limited Partners of these private equity funds. By becoming so, the pension schemes will be exposing the retirement savings of their members to differentiated investment opportunities within their own countries and the East African region, currently only attainable by investing in private equity as an asset class.

2.2 High-level appreciation of the East African regulatory environment

Table 1: East African pension regulatory environment

	Kenya	Rwanda	Tanzania	Uganda
Estimated value of pensions market (US$ millions)[1]	11,512	735	4,927	2,659
Regulatory authority	Retirement Benefit Authority (Kenya)	National Bank of Rwanda	Social Security Regulatory Authority and Bank of Tanzania	Uganda Retirement Benefits Regulatory Authority
Prescribed asset allocation limits	Yes Table G Legal Notice 107	Yes National Bank Prudential Guidelines	Yes Social Security Schemes Investment Guidelines	Yes URBRA Investment of Scheme Funds Regulation 2014

[1] The estimated value of pension scheme assets was taken from most recent regulatory reports available for each country with the US Dollar conversion of local currency values taken as at the spot rate at the time of writing (May 2019).

	Kenya	Rwanda	Tanzania	Uganda
Allowed to invest in private equity? (% of AUM)[2]	Yes 10%	Yes 20%	PE – Yes (subject to Bank approval) VC – No	Yes 15%
Current allocation to private equity	0.07%[3]	TBC	TBC	2.2%[4]
Can they invest outside of their countries (private equity)	Yes	Yes – Subject to National Bank of Rwanda prior approval	Yes – Subject to Bank of Tanzania prior approval	Yes – subject to prior approval of the Authority

Ethiopia: No data was available at time of publication; however through the offices of EAVCA, on-going engagement with the pensions and savings regulatory authority and key industry stakeholders in Ethiopia will enable data for Ethiopia to commence being periodically compiled, collated and published.

Can East African pension funds allocate to private equity?

Across all the representative countries, private equity is a legally recognised asset class for investment. It is important to appreciate that all pension schemes are subject to regulatory oversight, which implies that the Trustees are obliged to make asset allocation decisions within a framework set down by the requisite regulatory authority in each jurisdiction. Regulation limits the asset allocation decision of the Trustees. Generally, this limitation is expressed by way of setting absolute upper limit exposures to asset classes. Within the representative countries, the lowest allowable weighting to private equity is 10% in Kenya, while the highest allowable weighting is 20% in Rwanda. Tanzania is the only representative country where the regulatory authority (Bank of Tanzania) does not provide a percentage prescription, but rather compels Trustees serving pension schemes in Tanzania, to approach the Bank of Tanzania for approval.

Size matters

The provision of a threshold, however, must also be considered within the context of the size of East African pension funds. For example, a pension scheme with a value of US$10 million, and allocation of US$1 million to private equity, would constitute a 10% allocation. As seen on Table 1 above, the average allocation to the asset class, by Kenyan pension schemes, for the year ended 31 December 2018, was 0.07%. For the pension scheme with an asset value of US$10m (KES 1billion – a large[5] scheme in the Kenyan pension scheme environment), an allocation of 1% to private equity would equate to US$100,000. The minimum investment threshold for most private equity funds is much higher than US$100,000. However, discretion is afforded to the General Partners to grant a waiver to investors that do not meet the minimum threshold for investment.

Related to this specific example, using the Kenyan pensions environment as a proxy, the primary source of industry data was the Retirement Benefits Authority (RBA) website (www.rba.go.ke); no detailed data were available that provided granular-level statistics, such as the number and size of pension schemes with direct exposure to private equity funds. RBA-sourced data was augmented with data from a quarterly industry survey undertaken by an employee benefit administration firm in Kenya. From this survey (March 2019), of a total sample size of 426 Kenyan pension schemes, representative of a total value of KES 813 billion (circa US$8,13 billion), 106 schemes (25%) were reported to have assets values of US$20 million and above. Of the 106 schemes, 31 (7%) were reported to have Strategic Asset Allocations with the capacity/likelihood of allocation to private equity as an asset class (given the risk profile of the scheme) see Annex A – Pension Scheme Case Study – Kenya Power.

Below is an extract of data compiled from three Kenya-domiciled private equity funds that have raised capital from East African pension schemes within the last three years (2016 – 2018):

[2] The allowance to invest in private equity as a percentage of assets under management was as per the Investment Guidelines for each country.
[3] Retirement Benefits Authority (Kenya), "Retirement Benefits Industry Report for December 2018".
[4] Uganda Retirement Benefits Regulatory Authority, "Retirement Benefits Sector Annual Report, 2017".
[5] For the purpose of the Report, the classification for "Large Scheme" was taken from a quarterly investment performance survey of Kenyan pension schemes. Within this quarterly survey, large schemes have been classified as schemes with asset values greater than five hundred million Kenyan Shillings and less than two billion Kenyan Shillings. Further, the survey is derived from the submissions of Kenyan investment managers with balanced mandates. Regrettably, the survey submissions exclude asset allocations to direct property and private equity.

Table 2: East African Pension scheme percentage contribution to total funds raised by select private equity funds

Private equity fund	% contribution East African pension schemes to the fund size
Fund 1	44.00%
Fund 2	3.30%
Fund 3	7.68%
Total	Fund size: US$270 million

Source: EAVCA

Investment practitioners proffered the logic that outside of the very large East African pension scheme, the smaller pension schemes (by value) or those pension schemes with limited investment governance resources would struggle to implement a meaningful private equity investment programme successfully. Where the size of the scheme or the investment governance required by pension schemes prove to be key limiting factors, an alternate route to consider for pension schemes is the multi-manager model.

The multi-manager or fund-of-fund (FOF) option is designed to reduce some of the single manager risks and have experts take over the daily governance, fund construction and manager interaction, on a mandate from the fund.

Advantages and disadvantages of the multi-manager approach

Advantages

- The main advantage of investing via an FOF is that the FOF usually has long-standing relationships with many of the managers and has good knowledge of the investment landscape. This is useful as it would address the expressed reservations of East African pension scheme trustees on the lack of directly available benchmarking and performance data.
- It removes the research and investment governance burden from the trustees to dedicate the resources required to formulate a credible portfolio of diversified private equity managers and underlying private equity funds.

Research suggests that FOFs tend to have uniform and in-depth dedicated manager assessment, operational management, and risk management processes tailored to the intricacies of the asset class. This management function includes appropriately managing cash flows and distributions of investment returns over multiple funds and structures. The FOF should also be able to add value through direct secondary transactions and co-investments. Many FOFs in the developed world have transformed into dedicated secondary or co-investment funds.

Disadvantages

- Potentially higher fees for the service, which can often involve both a management and a performance fee.
- These fees are on top of the existing fees, which need to be paid to the underlying managers in the portfolio and can significantly reduce the ultimate returns to the investor.

Diversification considerations

In part, linked to the consideration mentioned above, pension scheme trustees also need to think through diversification considerations as part of their private equity investment programme. Continuing the example mentioned of the US$10 million pension scheme, an allocation of US$100,000 is likely to only allow for subscription to one private equity fund – introducing unintended concentration risks to the scheme's investments. Prudence would require the scheme to consider more than one fund in which to invest, to fulfil the requirement for a diversified allocation to an asset class.

Asset allocation decision-making: the influence of government bonds in East Africa

Table 3: East African pension scheme asset allocation to government bonds

	Kenya	Rwanda	Tanzania	Uganda
Allowed to invest in government bonds (Max %)	90%	55%	70%	80%
Average local currency yield per annum (medium-term government bond)[6]	10%-12%	12%	14%-15%	14%-17%
Average local currency yield per annum (Treasury bills)	7%-9%	5%-7%	8%-9%	9%-11%
Pension fund fixed income asset allocation	40%	17%	18%	72%
Annual inflation (IMF Regional Outlook Apr 2019)	5%	1%	3%	3%
Latest fixed income auction - +over/undersubscription?	+Over	+Over	+Over	+Over
Average age of working population (2017) Population ages 15-64 (% of the total population)	57%	57%	52%	50%

Sources: 1. Regulatory publications: Kenya, Rwanda, Tanzania, Uganda, 2. Central Bank publications: Kenya, Rwanda, Tanzania, Uganda, 3. Central Bank publications: Kenya, Rwanda, Tanzania, Uganda, 4. UN Human Development Index: http://hdr.undp.org/en/2018-update, accessed July 2019.

Anecdotally, the combination of:

- High effective real yields
- Regulatory guidance allowing for +50% allocation to fixed income
- Implicit capital guarantee and tax-exempt status on government-issued fixed income securities

all contribute to the limited diversification in the asset allocation across East African pension schemes

The diversification benefits provided by an allocation to private equity would need to be very compelling to motivate any re-allocation decision from the existing status quo, with regards to the high allocations to government-issued securities. It should, however, be pointed out that the asset allocation allowances, if followed blindly by the Trustees of pension schemes, may turn out to be detrimental. The application of a uniform asset allocation across all pension funds, implicitly assumes that the membership profiles of all pension funds are the same and the liability profiles would all be most suited to the uniform

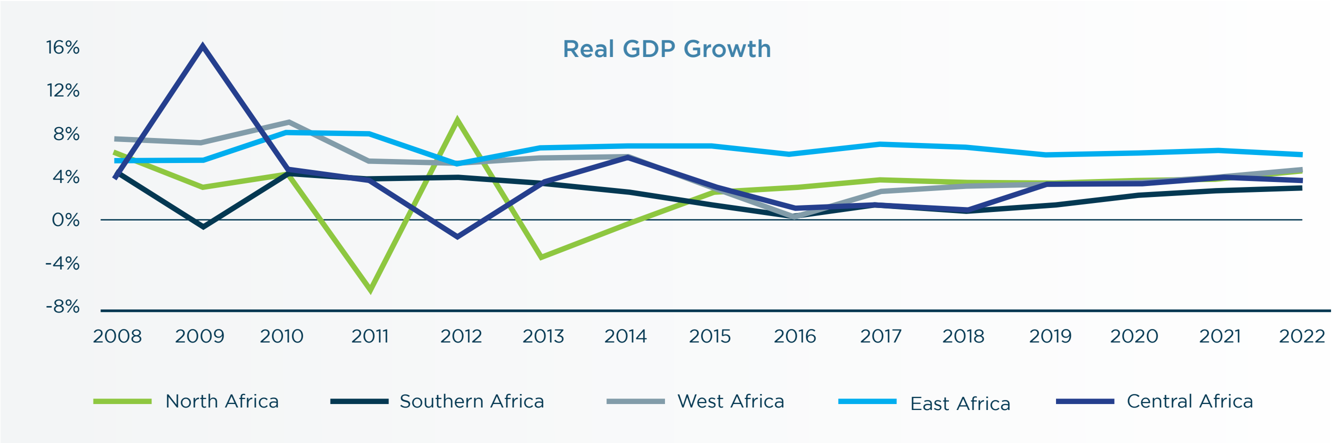
[6] Medium Term Bonds for the purpose of this survey are government bonds with final date of maturity (from initial date of issuance) being greater than three years, but less than ten years.

application of exposure to a specific asset class. The liability profiles of pension schemes differ; for example, pension schemes in East Africa may prove to have young contributory members. For these (young) pension schemes, a higher allocation to fixed income may prove to be incorrect; younger pension schemes may prove to have liability profiles that support a proportionally higher allocation to growth assets. The high allocation to fixed income, detracts from an allocation to growth assets (e.g. listed equity and private equity), which not only provide diversification benefits to the pension schemes, but also the opportunity to expose pension schemes to high growth assets.

2.3 High-level summary of the East African macro-economic landscape

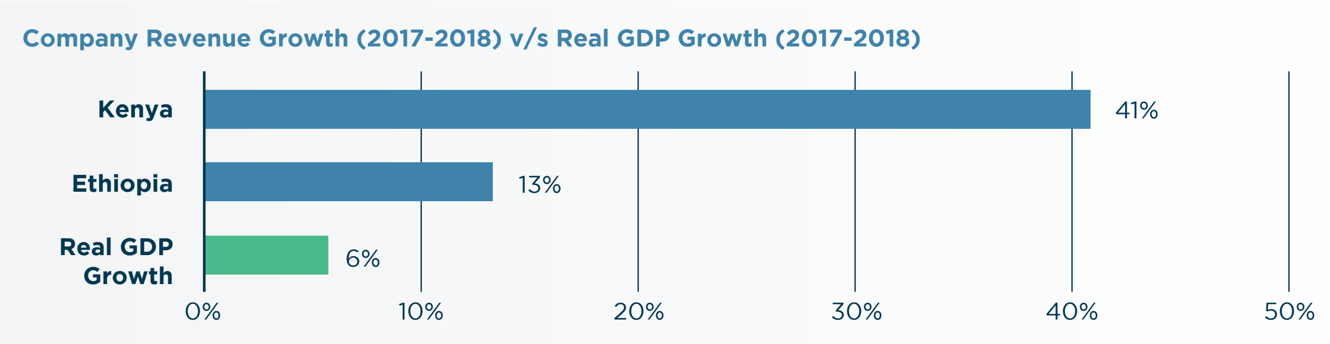
Perhaps the macro-economic background has been a key driver for scheme trustees in East African pensions to err on the side of caution when considering an allocation to private equity as an asset class? The bias to fixed income as an allocation implies a negative outlook on asset classes, which are well-disposed to positive economic growth prospects. The economic outlook for East Africa (see Figure 1) certainly does not give credence to the need for conservatism; on the contrary, the growth prospects for East Africa in comparison to the broader continent and in global terms are compelling.

Figure 1: East Africa Gross GDP growth – current and forecast compared to other African regions[7]



Scheme trustees may contend with there being a disconnect between the macro-economic prospects of their respective countries and the performance of private equity as an asset class. Figure 2 is a depiction of the revenue (top-line) performance of private equity investee companies of an assortment of leading Africa-focused private equity funds compared to GDP; private equity exposure provides pension schemes leveraged exposure to underlying GDP

Figure 2: Private equity leveraging Africa GDP growth

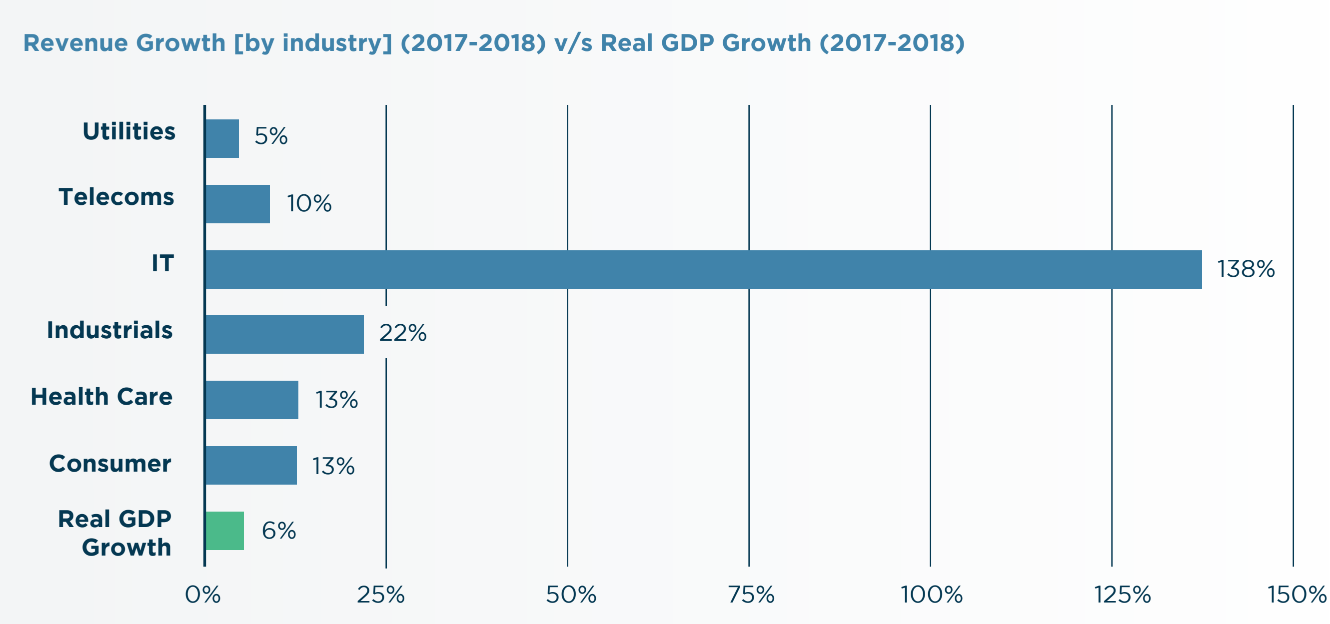


Source: South Suez Capital & African Development Bank
(Real GDP Growth refers to Real GDP Growth for East Africa as a region)

[7] IMF Regional Outlook Apr 2019

A differentiated depiction of the underlying economic growth accessible through the lens of private equity is provided below in Figure 3, by industry sector:

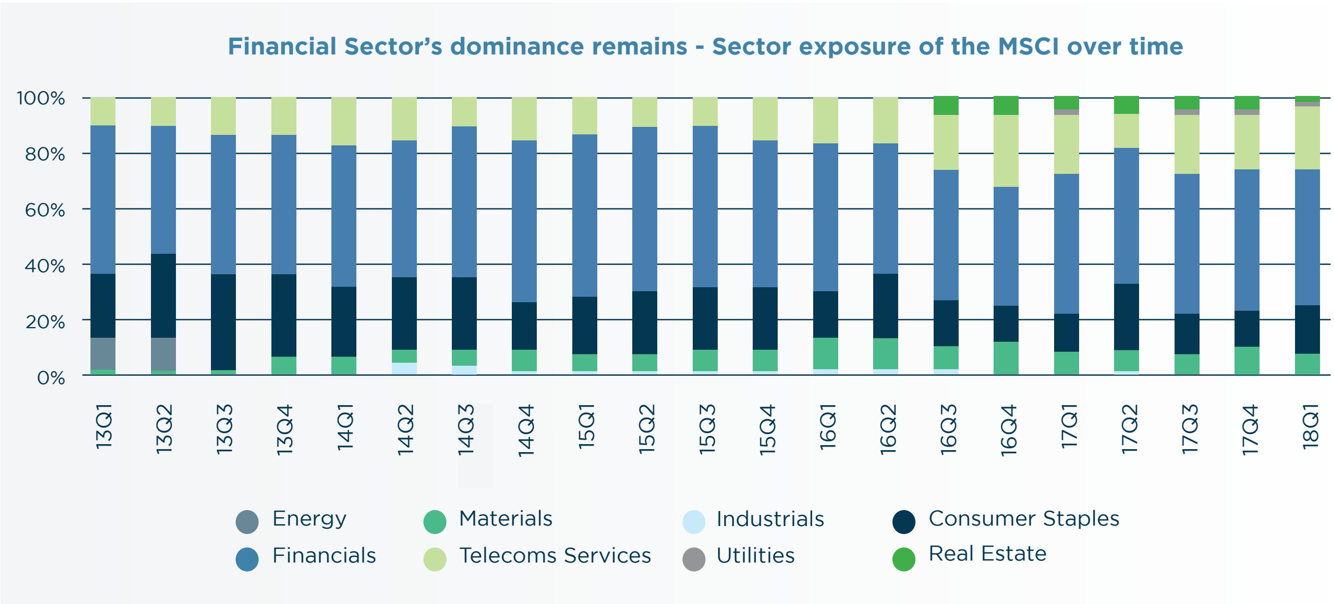
Figure 3: Industry revenue growth vs real GDP



Source: South Suez Capital & African Development Bank
(Real GDP Growth refers to Real GDP Growth for East Africa as a region)

Pension scheme trustees may further contend that the schemes already achieve exposure to the growth potential within their respective economies by being active investors in their respective stock exchanges. However, there is limited diversity across African stock exchanges (see Figure 4), when compared to the diversity of the broader economy. There is, therefore, under-representation of the broader economy in the current investable universe available to the East African pension schemes.

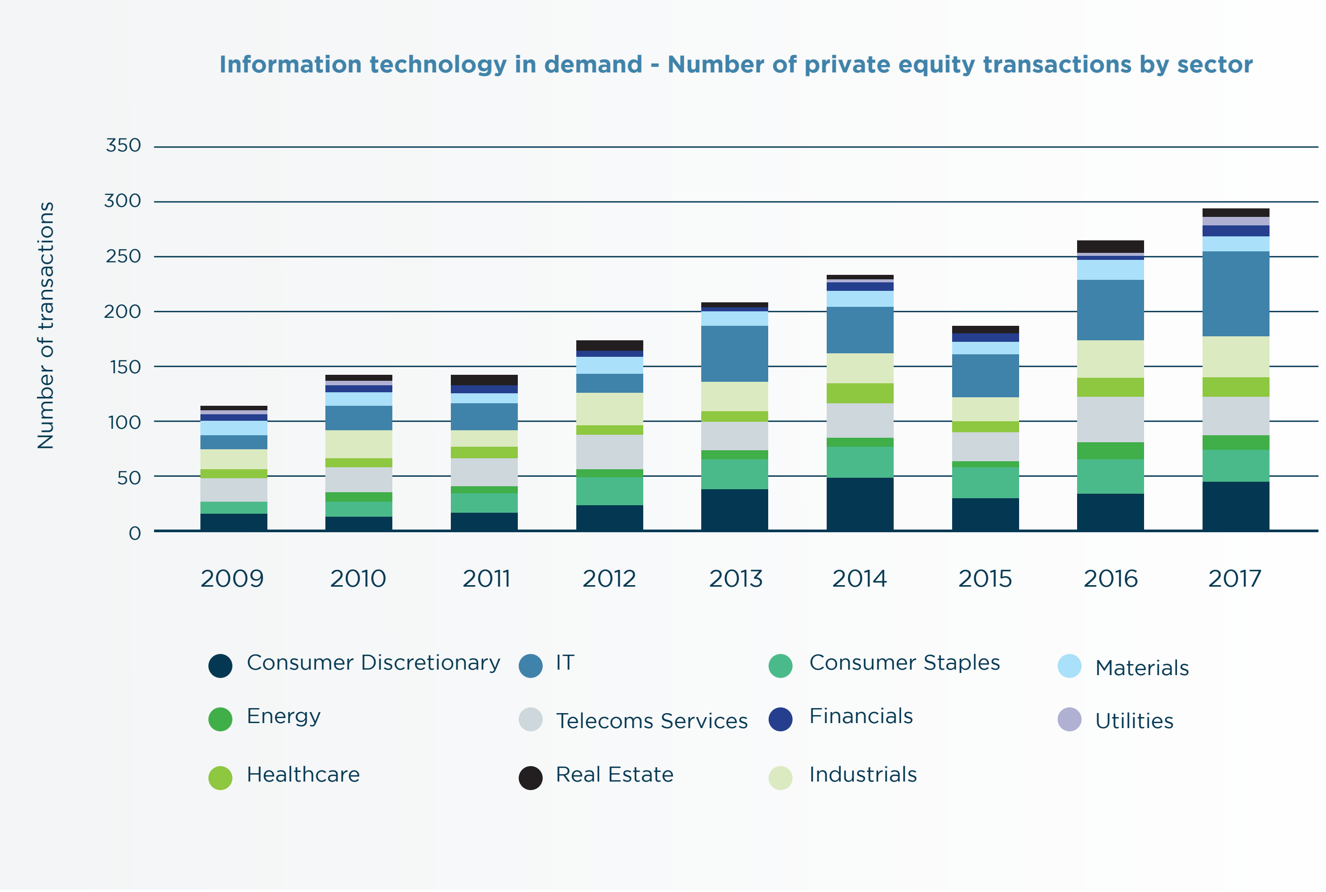
Figure 4: Tracking industry diversity across African stock exchanges



Source: MSCI, RisCura analysis

Private equity exposure/allocation would provide pension schemes with exposure to those sectors that are under-represented in the listed equity universe and not available via the current allocations to fixed income. Using the number of transactions (deals executed) by private equity firms, exposure to different economic sectors is provided below in Figure 5.

Figure 5: Number of private equity transactions across industry sectors



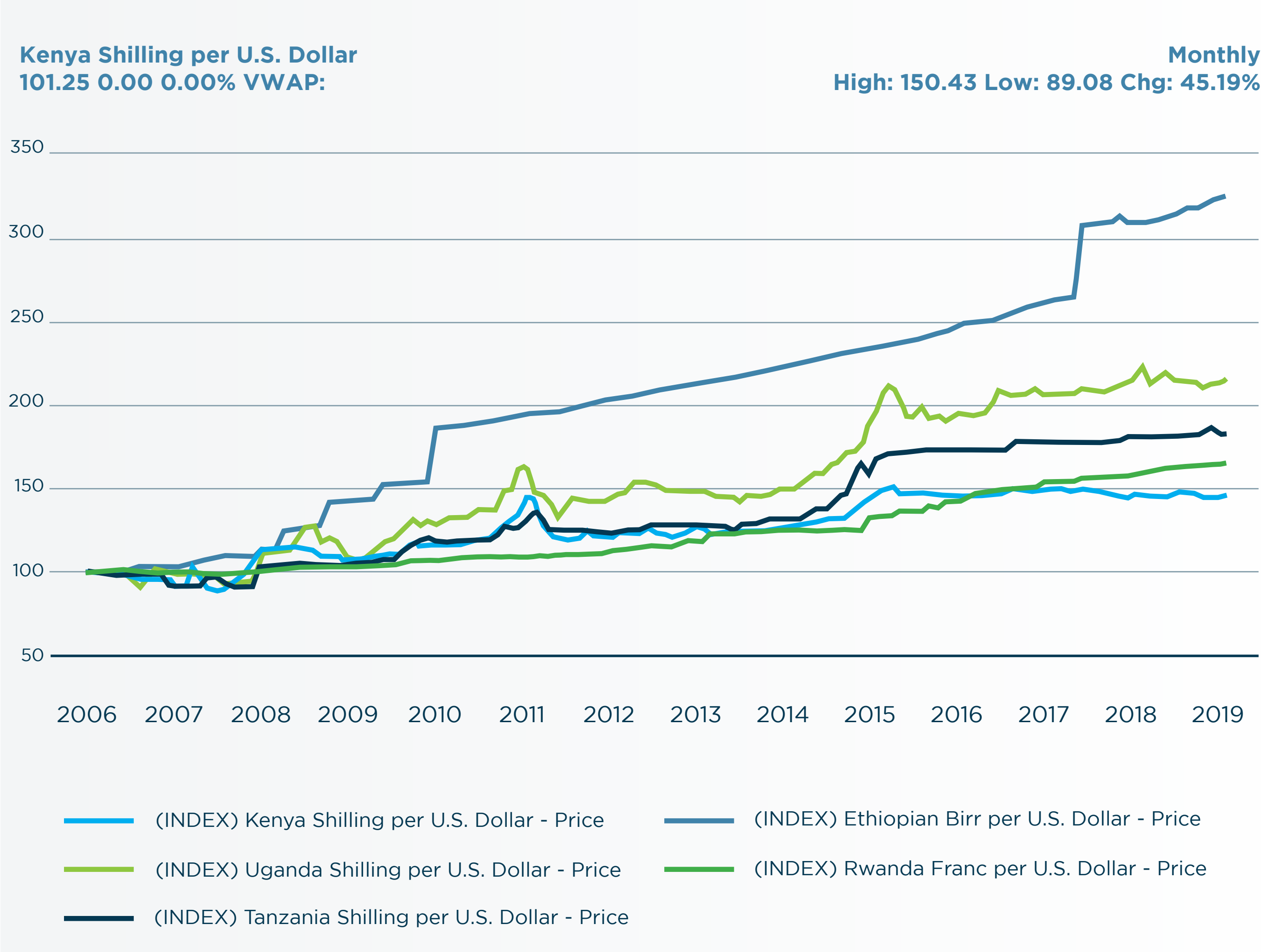
Source: RisCura, S&P Capital IQ

2.4 High-level summary of the limitations international investors face

2.4.1 Depreciating currencies

Local currency Limited Partners will not have had to contend with the currency volatility that international Limited Partners have had to accept as reality, and which they need to factor into their investment thesis for Africa. The Kenyan Shilling (from the basket of East African currencies depicted) has proven most stable, albeit with a 31% depreciation against the US Dollar over the ten-year assessment period, in contrast with the Ethiopian Birr, which has lost 69% of its value over the assessment period.

Figure 6: Tracking East African currencies vs. the US Dollar



Source: FactSet, RisCura

East African pension schemes can therefore serve as an important source of long-term, local currency patient capital required to support the growth of unlisted African companies, in a manner that foreign Limited Partners are otherwise unable to, particularly because international Limited Partners have an expectation to be repaid in US$. For the underlying investee companies and the General Partner (GP), having local currency long-term capital may ease the pressure on both GP and the investee company when attempting to execute their value enhancement plans through operational margin improvement and organic growth. These fundamental drivers to value enhancement should be easier to attain without the additional pressure of contending with economic bouts faced by many African countries where the currencies depreciate.

2.4.2 Capacity for longer holding periods

The General Partners surveyed, affirmed continued preference for the 'growth equity' private equity investment model. Growth capital is also referred to as 'expansionary capital', where a private equity fund invests equity, usually by way of a minority investment in relatively mature companies that are looking for capital to expand or restructure, enter new markets, or finance a significant acquisition without a change of control for the business. This model, therefore, presents a scenario where the risk of impairment of capital or loss is mitigated.

However, this specific type of investing model is reliant on several facets being simultaneously congruent, namely: strong alignment of interest between the GP and investee company owners; an overall supportive and stable economic environment; and general predictability (primarily) in the exchange rate. In recent times, the unpredictability in the economies and exchange rates has resulted in a higher degree of difficulty faced by General Partners when executing the initially envisaged value enhancement, and specifically exits from the underlying investments.

This effect has been evidenced in research conducted by EY and African Venture Capital Association (AVCA,) where for East Africa, the region recorded a decline in its proportional weight of exit activity on the continent, in that over the measurement period 2007–2017, East Africa's share of continental exits was 10%. This proportion declined to 8% over the period 2016–2017.

Table 4: Regional view of private equity exit activity

	2007 – 2017	2007 – 2015	2016 – 2017
North Africa	14%	12%	22%
West Africa	23%	25%	16%
Central Africa	1%	1%	0%
Southern Africa (excl. RSA)	9%	9%	8%
South Africa	43%	42%	45%
East Africa	10%	11%	8%
TOTAL	100%	100%	99%

Note: Percentages may not total 100% due to rounding.
% indicated is of the total exit volume

Source: African Venture Capital Association & EY

East African pension schemes should, therefore, appreciate this data as being anecdotal of the evolution of the private equity fund model in Africa and more specifically, East Africa. The traditional hypothesis of the GP being able to invest drawn down capital within an initial five-year time horizon and return the capital (plus return on the capital) on or around year ten is being challenged on the continent and more specifically in East Africa.

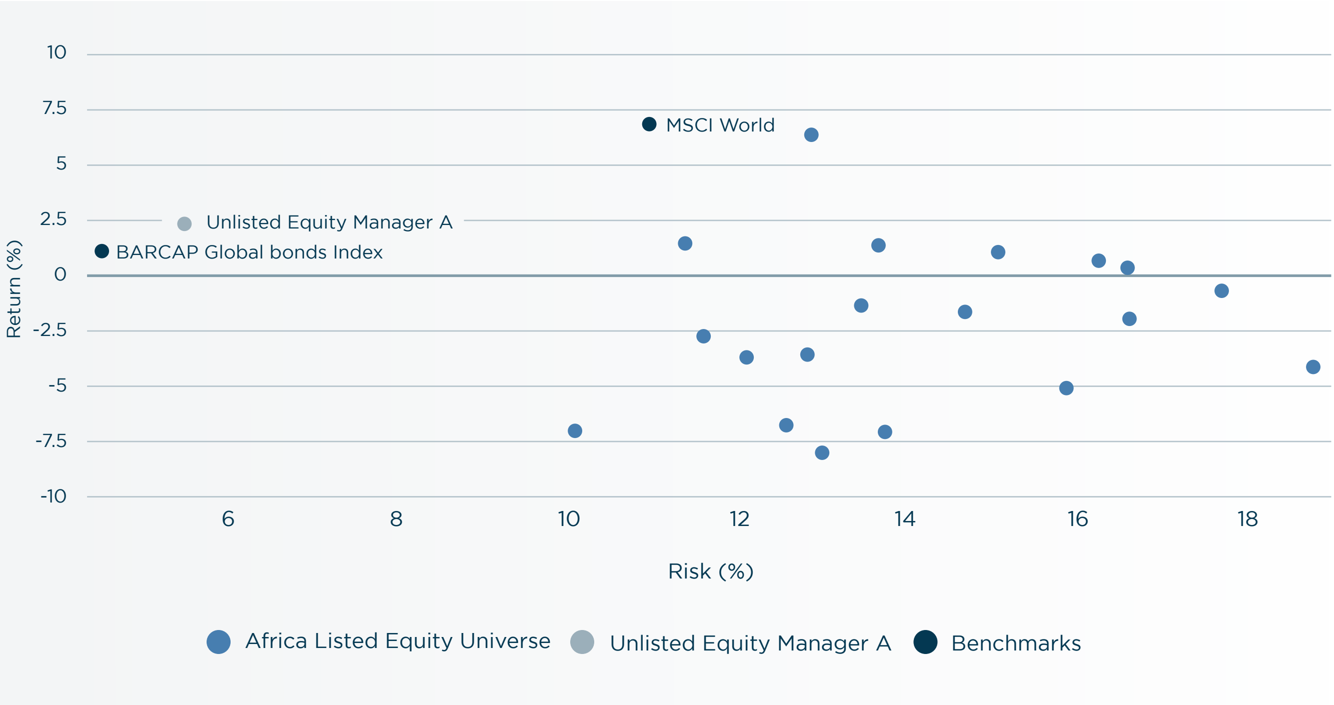
East African pension schemes are therefore being presented at this juncture, with favourable strategic optionality in attaining exposure to private equity as an asset class. In the first instance, East African pension schemes are presented with the ability to participate as primary investors in private equity funds and can secure the first right of refusal from other Limited Partners that may be bound to exit within a pre-determined timeframe. This timeframe is often much shorter than the investment horizon/holding period of an East African pension scheme. In a second iteration, East African pension schemes may elect to attain exposure to the asset class by dedicating their capital to secondary funds.

2.5 Addressing the perception of private equity as a risky investment

Risk (Volatility)

For African public and private investment managers, the combination of risk vs. return metrics offered by Africa more broadly as an asset class, immediately places limitations as to the quantum that most global investors are willing to make this allocation, (i.e. the risk as measured by the dispersion of returns). This risk profile can reduce the consideration for African assets, and where allocation is made, it is kept at low levels compared to other geographic global allocations. This low competition from foreign investors presents an opportunity for African pension schemes.

Figure 7: 60-month private equity risk vs. return scatters



Source: RisCura

The return series above (Figure 7) depicts the 5-year performance of:

Global Indices	Africa Public and Private Market Managers
• Proxies for developed market allocations • Low volatility (risk)	• Investable Africa universe • Higher volatility (risk)

- Africa public equity managers demonstrate the variability of returns as depicted by the majority of the Africa public equity funds that are delivering returns for a comparably higher risk, to both the developed equity and developed bond indices.
- Private equity has delivered positive returns over the period with comparable low volatility when compared to Africa public equity and developed market equity (see tables below).
- It should be appreciated that 60 months represents a limited timeframe for institutional investors, in addition to the fact that the decision-making to invest in African public and private markets will be made within the context of prudential risk budgeting. The risk vs. return profile of Africa public and private market strategies will, therefore, be allocated (strategically) within a certain risk budget framework and accordingly, the capital allocation for that risk budget will be sized commensurately.

2.6 In conversation with investment practitioners in East Africa

As part of the background research to the Market Study, interviews were conducted with representatives from different constituencies of the investment management industry in East Africa: investment managers, fund secretaries, and private equity industry representatives. Below are discussion points that were collated from these conversations that provide additional context to the limited allocations to private equity by East African pension schemes to date.

2.6.1 Re-thinking the role of investment policy statements and investment mandates

Investment policy statements

All registered pension schemes must have investment policy statements (IPS). These are drafted by service providers, normally the actuary, fund manager or investment consultant. The IPS provides guidance for the strategic asset allocation (SAA) for the pension scheme and where a scheme's IPS has provisions for it, there will be an allocation to private equity.

The drafting of the IPS will generally be guided by the regulatory investment guidelines for pension schemes. Where the guidelines provide an explicit reference to private equity as an asset class, the drafters of the IPS can proceed to provide specific reference and guidance to the Trustees. This guidance includes the size of the allocation to private equity (considering the specific constraints of the pension scheme) and returns that the scheme should expect from this asset class.

In instances where the regulatory guidelines do not explicitly name private equity as an asset class, schemes can refer to the guidelines providing for investment in "other asset classes" or "unquoted equity". The lack of clear guidance within the regulatory guidelines often then poses a limiting factor in the Trustees' decision-making process as to how to populate these unclassified asset allocations. As a result, there is no obligation to the IPS drafter to consider allocation to the nonspecific categories. Thus, even though the regulation may not specifically prohibit investment in private equity, regulatory classification in such instances would be cited as a limiting factor. The lack of (or perceived) absence of regulatory oversight of the General Partners may also be a limiting factor in that it forms part of the Trustees' decision-making process regarding allocating private equity.

It is similarly important to appreciate the governance arrangements that some public pension schemes must adhere to. For example, certain aspects of the investment process of public pension schemes are subject to a Public Procurement Act(s), which introduces a bureaucratic process that can impede the pace of decision-making by the pension scheme. Some industry practitioners proposed that pension scheme trustees should develop and/or adopt a specific IPS for private equity, given the specialist nature of the asset class. Within this specialised IPS, the pension scheme trustees could detail the manner by which their pension scheme shall invest in private equity as an asset class.

The current drafting of the IPS has an implicit assumption that the Trustees (in consultation with the delegated service provider), should be able to attain exposure to the identified asset class, without additional trustee education or policies and procedures, to ensure proper risk management for the pension fund. For example, the allocation to fixed income or public equities is catered for through the investment mandate between the pension scheme and the delegated investment manager. The investment manager has the requisite skill and know-how to receive the allocated funds from the pension scheme and accordingly invest in the underlying securities. With private equity, even with the IPS affording the pension scheme the ability to allocate to the asset class, it may not provide the requisite policies and procedures to implement this decision. (For example, the Trustees must perform due diligence on the proposed private equity fund; the Trustees must review the limited partnership subscription agreement, etc). In some East African countries (such as Tanzania and Rwanda), the Trustees must then demonstrate these aspects to the regulator before receiving approval to invest in private equity as an asset class. The aspects above speak to the need for a specific governance document that would not only guide the Trustees but also satisfy the regulators that due diligence and the requisite investment governance processes have been adhered to by the Trustees.

Finally, the IPS is not a static governance document. Rather, it is subject to review (generally) every 24 to 36 months, or more frequently should there be a material change to the asset or liability profile of the scheme. In this regard, it is possible for the IPS to be amended to include private equity as part of the asset allocation (if absent), or for the manner in which the pension scheme looks to achieve exposure to the asset class being modified for the specific requirements of the pension scheme, so as to implement the SAA to private equity.

Investment mandates

The investment manager's relationship with the scheme is captured in an investment mandate, which outlines what the investment manager can invest in, amongst other service levels. While the IPS may allow the scheme to invest in private equity, the investment mandate between the scheme and the incumbent investment manager(s) is constrained.

Generally, most pension schemes in East Africa enter balanced mandates[8], without a specific reference to private equity. Thus, the Trustees must either:

1. amend the existing mandates with the incumbent investment managers to allow investment in private equity as an asset class, or
2. enter specialist mandates with specialist private equity managers.

[8] Balanced mandate: where the Trustees award an investment manager with a single investment mandate to invest across two or more asset classes to achieve diversification.

Under (1) above, the schemes need to evaluate the following: Do the incumbent managers (existing asset managers) possess the skills, expertise, and track record for investing in private equity? Were they hired to invest in such a specialist asset class when the initial mandate was drafted?

Under scenario (2) above, the Trustees would need to research, assess and select the appropriate manager(s) who would provide the scheme exposure to private equity as an asset class – with the assumption that the Trustees have the requisite skills and expertise to perform this function.

The expectation amongst some Trustees and regulators is that the Trustees should delegate the research and assessment of private equity managers to their incumbent investment managers. While this may be expedient, the incumbent investment managers may also lack the skill and expertise to review and make recommendations on private equity managers and private equity funds. In addition, from a commercial perspective, such a task may not make commercial sense for the incumbent investment manager, as they may not be able to charge any additional fees for such work, given their mandate is constrained to the research and selection of investment securities and not of private equity managers or private equity funds.

Investment implementation

As previously mentioned, the process that the pension scheme must follow to implement their desired exposure to private equity (PE) as an asset class is distinct from the traditional asset classes in the following ways:

- It is likely that the pension scheme board will request their legal counsel to review the contractual agreements that the scheme will become a party to.
- The agreements are largely standardised and follow standard templates. However, as part of their fiduciary duty, it is incumbent on the trustees of pension schemes to demonstrate their understanding of these contracts, particularly because they are binding for 10 – 15 years.
- The post-investment monitoring and reporting process for PE is also distinct, requiring the schemes to incorporate this aspect into their current reporting and valuation processes.

With regards to investment implementation, this aspect can be made less onerous as the Trustees can look to learn and incorporate best practice from the Institutional Limited Partner Association (ILPA) (www.ilpa.org)

2.6.2 Introducing an investment governance model that may accelerate adoption of private equity by East African pension schemes

East African pension schemes have cited a limiting factor for accelerated adoption as the absence of an industry benchmarking tool to reference their assessment of private equity funds and managers before investing. This lack of benchmark is not limited to private equity as an asset class. In general, where an asset class is established, where benchmarks are clear, and where market data is efficient, pension schemes are better enabled to apply a decision-making process that allows them to research, assess and select investment managers directly.

The only available Africa-wide benchmarking data is the Africa Private Equity & Venture Capital Index, first launched in April 2013 as a joint initiative between the Africa Venture Capital Association and Cambridge Associates. The index comprises 50 funds focused on private equity and venture capital investments in Africa. The index includes pan-African, regional, and country-specific funds (13 of which are focused primarily on South Africa).

Table 5: Africa private equity & venture capital – Fund Index Summary (horizon pooled return) 30 September 2018

Index	1 – Quarter	YTD	1 – Year	3 – Year	5 – Year	10 – Year	15 – Year	20 – Year
Africa Private Equity & Venture Capital Index	1.42	2.72	6.95	3.71	2.81	4.77	7.43	6.64
Africa ex-South Africa Private Equity & Venture Capital Index	1.72	4.50	7.74	4.05	3.31	5.10	7.10	6.79

Index	1 – Quarter	YTD	1 – Year	3 – Year	5 – Year	10 – Year	15 – Year	20 – Year
MSCI Emerging Markets Index (gross)	-0.95	-7.39	-0.44	12.77	3.99	5.76	10.02	10.17
MSCI World ex US Index (net)	1.31	-1.50	2.67	9.32	4.24	5.18	6.85	5.37
MSCI World Index (net)	4.98	5.43	11.24	13.54	9.28	8.56	8.15	6.15
MSCI Emerging Frontier Markets Africa	-7.31	-20.21	-4.60	3.88	0.25	4.21	9.36	n/a

Source: Cambridge Associates LLC

Private equity in Africa (outside South Africa), still exhibits the following limiting factors:

- Data and information flow is inefficient.
- Benchmarks are limited, with the submission of data to the benchmarks, intermittent at times.
- Diversification of managers is a necessity for performance enhancement and as a risk mitigation tool.
- Portfolio allocation, as a percentage, is small (compare allowable private equity allocation to fixed income for example).

3 The Survey

3.1 Defining the market

In defining the 'market' the approach was to look at what were deemed to be key stakeholders in the private equity ecosystem in East Africa.

Table 6: Stakeholder roles within the private equity ecosystem

Stakeholder	Role within the private equity ecosystem
Capital Providers	**Pension funds:** • Provide long-term ('patient') capital, necessary given the intrinsic feature of the traditional private equity funding model; • Would serve as the Limited Partner within the traditional private equity governance model.
Capital Deployers	**Private equity funds:** • Are users of the ('patient') capital provided by Limited Partners; • Are necessary intermediaries that channel savings towards unlisted investment opportunities; • By design, exposure to this alternative asset class presents the capital provider with exposure to an asset class that provides a differentiated risk vs. return profile to their traditional asset classes.
Regulatory and Capital Market Authorities	**Regulatory and capital market authorities:** • Provide for and regulate the environment within which the capital provider and deployer operate; • Regulatory action and policy direction afforded by this stakeholder ultimately have a long-term bearing on the development of the ecosystem.

3.2 Feedback from the survey

The survey was administered through a combination of online tools, telephone interviews and face to face interviews and was run from 15 October 2018 to 15 May 2019. The targeted respondents were: private equity practitioners (General Partners) investing in East Africa, except development finance institutions, philanthropy and impact funds; pension funds with assets under management above USD 50 million – being the theoretical threshold for uptake of private equity; and regulators with interest in the private equity space (retirement benefit and capital markets authorities). Responses were not received from all the stakeholders; however the statistical threshold of 30% of the sample was surpassed.

18	15	3
PENSION FUNDS	GENERAL PARTNERS	REGULATORS

Response by Country		East Africa Investment Base		Regulatory Footprint	
Kenya	14	Ethiopia	1	Kenya	1
Rwanda	1	Kenya	13	Uganda	1
Tanzania	1	United Kingdom	1	Tanzania	1
Uganda	2				

3.2.1 Pension funds (Limited Partners)

In Kenya, the Association of Retirement Benefit Schemes (ARBS) is the umbrella association of such schemes. The ARBS has the widest grouping of pension funds as member schemes on its database. In Uganda, the Uganda Retirement Benefits Regulatory Authority (URBRA) assisted in providing a list of key pension schemes. For Rwanda and Tanzania, direct contact was made with key pension funds within each respective country. It therefore made sense to use the auspices of these industry umbrella bodies as well as regulatory authorities, to assist in the efforts of raising awareness of the initiative amongst their constituent members. The most efficient medium to pose questions to pension funds was an online survey, where the collection, collation, and compilation of their responses could easily be centralised.

The industry umbrella bodies and regulatory authorities were requested to assist by circulating an electronic letter to pension funds, prompting the pension funds to participate in the survey by following the link provided, as below.

https://www.surveymonkey.com/r/PrivateEquityandPensionFunds

RESPONSES TO THE SURVEY QUESTIONS BY LIMITED PARTNERS

Please rate the level of understanding of the following terms, within the context of Private Equity Fund Management.

Scale of response: 1. Little or no understanding « ——— » 5.Excellent understanding

Key Terms	1	2	3	4	5	Total
Limited Partner	17%	11%	44%	11%	17%	100%
General Partner	17%	11%	44%	11%	17%	100%
Drawdown	6%	17%	28%	17%	32%	100%
Commitment	11%	17%	11%	33%	28%	100%
First Closing	17%	6%	33%	22%	22%	100%

Key Terms	1	2	3	4	5	Total
Final Closing	17%	6%	28%	22%	28%	100%
Distribution	17%	17%	39%	6%	21%	100%
Carried Interest	39%	17%	0%	17%	27%	100%
High Water Mark	72%	0%	11%	0%	17%	100%

Survey finding explanatory notes

- Within the context of a survey of this nature, where the asset class is nascent, “Level of understanding” could also be inferred as whether the respondent is familiar with, or has had previous exposure and/or knowledge of the applicable key term.
- None of the respondents expressed no knowledge whatsoever of a key term.
- This implies some knowledge and/or familiarity with the term and an increased level of interaction (in all likelihood) with private equity funds looking to raise capital from East African pension funds.

A few summary inferences drawn from the responses are shown below:

<table>
<tr><th colspan="2">Key Terms</th></tr>
<tr><td>Limited Partner</td><td>• Within the context of private equity, the term refers to a defined (legal) role and responsibilities for investors.
The recorded low respondent understanding of the term infers lack of clarity amongst the majority of respondents of how to define and describe the term and in turn the legal standing, roles and responsibilities of a Limited Partner.</td></tr>
<tr><td>General Partner</td><td>• Generally a below-average understanding across the respondents of the term, comparable to the level of understanding of the term Limited Partner.</td></tr>
<tr><td>Drawdown</td><td>• An high understanding of this term.
It is conceivable that the term has been utilised and observed in other capital and investment scenarios that the respondent has been exposed to – the term is not unique to private equity.</td></tr>
<tr><td>Commitment</td><td>• A varied level of understanding of this term.
It is conceivable that the term has been utilised and observed in other capital and investment scenarios that the respondent has been exposed to – the term is not unique to private equity.</td></tr>
<tr><td>First Closing</td><td rowspan="2">• The respondents marked their levels of understanding with both terms exactly the same.
• In general, a lower level of understanding of both terms, that are commonly utilised within private equity.</td></tr>
<tr><td>Final Closing</td></tr>
<tr><td>Distribution</td><td rowspan="3">• In general, a lower level of understanding of both terms, that are commonly utilised within private equity.
• Particularly poor understanding of the term high water mark.
The consistently low levels of understanding across these selected key terms speak to the respondents requiring further training and education on the application and technical understanding of these key commercial terms within private equity.</td></tr>
<tr><td>Carried Interest</td></tr>
<tr><td>High Water Mark</td></tr>
</table>

See Annexure B – Glossary of Key Terms

Please rate the level of understanding of the following governance-related terms and matters, within the context of Private Equity Fund Management?

Scale of response: Y N

Key Terms and Matters	Y	N	Total
Have any members of your Board of Trustees ever served on an LP Advisory Board?	6%	94%	100%
Are you aware of the procedures/best practice generally followed in annual general meetings of private equity funds?	28%	72%	100%
Are you aware of the procedures/best practice generally followed in the instance of removal of the GP?	22%	78%	100%
Are you aware of the procedures/best practice generally followed in the instance of the resignation of a GP?	28%	72%	100%
Are you aware of the authority and responsibilities of the LP Advisory Board?	28%	72%	100%

Survey finding explanatory notes

- As Kenyan and East African pension funds consider investing in the asset class, an understanding of the key governance terms and procedures are key to Trustees demonstrating their fiduciary duty.
- Governance procedures serve as the primary means that Trustees will use to interact with the private equity vehicle.
- Understanding of the governance terms and procedures (within the private equity context) must be harmonised with the broader governance architecture of the pension fund.
- The consistently low levels of understanding across these selected key governance terms and matters would imply that the respondents require further education on the application of these key terms within private equity and the context in which each would arise.

Please rate the level of understanding of the following commercial terms and matters, within the context of Private Equity Fund Management?

Scale of response: 1. Little or no understanding « —— » 5.Excellent understanding

Key Terms	1	2	3	4	5	Total
Please rate your level of understanding of the term 'Carried Interest'?	39%	17%	0%	17%	27%	100%
Please rate your understanding of the norms or generally accepted practices with regards to milestones that the GP must meet before the GP can start taking or take additional carry.	50%	17%	11%	6%	16%	100%

Survey finding explanatory notes

- Commercial terms speak to the cost of investing in private equity (in comparison to traditional asset classes).
- Commercial terms represent alignment/misalignment of interest between the Limited Partners and General Partner.
- A critical and detailed understanding of the mechanics and calculations of fees and carried interest within the ongoing training and education of pension funds is deemed to be imperative.

Please confirm your familiarity with the following commercial terms and matters, within the context of Private Equity Fund Management?

Scale of response: Y N

Key Terms and Matters	Y	N	Total
Are you familiar with the difference between a 'hard' hurdle and a 'soft' hurdle?	18%	82%	100%
Has your pension fund ever considered or been approached to consider 'Co-Investment' opportunities in the private equity space?	53%	47%	100%
Does your pension fund have a specific policy or criteria with regards to co-investment?	29%	71%	100%
Are you familiar with the types of insurance policies that should be in place within a private equity fund management framework?	12%	88%	100%
Are you familiar with, or have you been exposed to the International Private Equity Venture Capital Valuation Guidelines?	12%	88%	100%

Survey finding explanatory notes

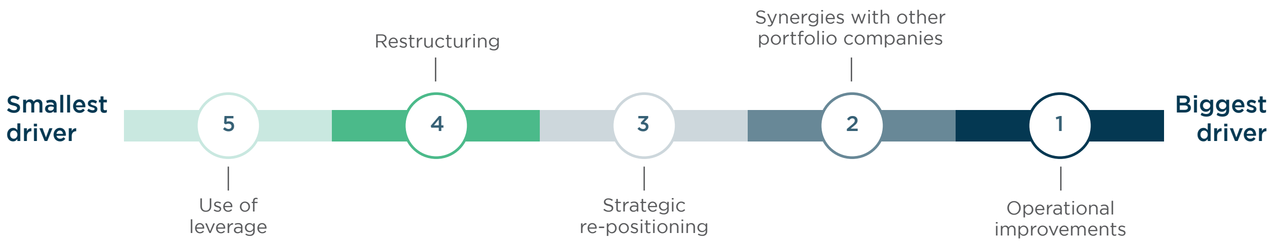
- When the responses to the governance considerations are compared alongside the commercial elements, a clearer picture emerges.
- There is generally a low level of theoretical understanding of the governance terms combined with limited practical and technical knowledge of the commercial terms of private equity investing. This outcome validates the necessity of this capacity-building initiative.
- Of concern is the near absence across most respondents of a distinct Private Equity Investment Policy document as part of the investment governance requirements of the fund, yet nearly half of the respondents have contemplated, or have been approached to consider co-investment opportunities.

3.2.2 Private equity practitioners (General Partners)

The East Africa Venture Capital Association (EAVCA) is the umbrella association for private equity funds and practitioners in Kenya and, East Africa. EAVCA already has the contact details of most private equity funds operating in East Africa; as a result, EAVCA was requested to use their existing database to disseminate the survey to all private equity members on the EAVCA database.

RESPONSES TO SURVEY QUESTIONS BY PRIVATE EQUITY PRACTITIONERS

Please rank the following from biggest to smallest in terms of their ability to drive the performance of your portfolio companies in the medium-term. Note that a rank of 1 would classify a factor as the biggest driver and 5 would denote the smallest driver.



Survey finding explanatory notes

- Commonality across a diverse set of GPs with regards to the area of focus that drives value creation.
- Minimal use of leverage as part of the investment thesis across a diverse set of GPs is in line with experience in Africa for private equity as an asset class.
- Minimum use of leverage also reflects the stage of development of debt capital markets in East Africa vs. developed markets.

Review of the operational risk and control environment of General Partners

- Operational risk and controls speak to the self-imposed diligence and prudence exercised by the General Partner.
- Operational risk and control environment also speaks to the level of resourcing (financial, legal, human capital) of a General Partner.
- A poor operational control environment can be used as a proxy to indicate a higher risk General Partner.

Scale of response: Y N

Key Operational Risk Matters	Y	N	Total
Does your firm have a dedicated investment operations team?	80%	20%	100%
Does the investment operations team also include dedicated individuals responsible for the GP's strategy/criteria/plan for exiting investee companies?	60%	40%	100%
Does the GP seek an independent assessment of its internal controls on a periodic basis?	73%	27%	100%
Does the firm use a standard IT package and/or internally developed software for business functions like portfolio management, administration and risk?	53%	47%	100%

Survey finding explanatory notes

- Resourcing varies between managers, reflected by the variation in the responses pertaining to the use of information technology in portfolio management and allocation of portfolio companies across the investment operations and front-line investment staff.
- Incongruent expectations from General Partners, of operational enhancements as the main lever of value enhancement within the portfolios; yet the resourcing experience across the General Partners speaks to some managers being deficient in this regard.

Return expectations

20-25% Gross IRR
*MAX 20%

15-20% Net IRR
*MAX 15%

x 3 MULTIPLE ON CAPITAL INVEST

Review of adherence to best practice

- The private equity investment practice is now standardised and global; the minimum expectation is for the GP to meet global investment performance thresholds.
- Adoption of certain environmental, social and governance principles (ESG). The United Nations-supported Principles for Responsible Investment (UNPRI) and Global Investment Performance Standards (GIPS) are increasingly becoming key assessment factors and indicators of the quality of a private equity investment house.

Scale of response: Y N

Key Global Best Practice Adherence Matters	Y	N	Total
Is the investment performance of the fund compliant with the most recent version of the GIPS?	29%	71%	100%
Does the firm have an ESG policy (or equivalent CSR/SRI policy)?	100%	-	100%
Is the firm signatory to UNPRI?	50%	50%	100%
Has the firm's valuation policy changed in the last five years?	33%	67%	100%
Is the fund following or will the fund shortly be following the most recent version of the International Private Equity and Venture Capital Valuation (IPEV) Guidelines?	93%	7%	100%
Is the fund valued or will the fund shortly be valued by an independent third-party valuation firm?	87%	13%	100%
Does the fund's LP Advisory Board approve or review valuations?	60%	40%	100%
Is the fund's audit firm unaffiliated with the GP/Manager?	87%	13%	100%
Is the audit firm the fund uses unaffiliated with any of the fund's current or former Key Persons?	93%	7%	100%
Are carry payments and carry allocations independently verified?	93%	7%	100%
Are carry payments and carry allocations independently audited?	87%	13%	100%

A few summary inferences drawn from the responses are highlighted below – the complete responses are included in the annexures:

Key Global Best Practice Adherence Matters	Inferences
Is the investment performance of the fund compliant with the most recent version of the GIPS?	• Low adoption amongst the East African respondents fits with the global experience, where adoption of GIPS compliant reporting amongst alternative investment managers remains low. • Global standards for alternative investment managers promote consistency on how performance, such as reporting Internal Rate of Return (IRR), is presented.
Does the firm have an ESG policy (or equivalent CSR/SRI policy)?	• Strong adoption and integration of ESG policies as part of the fabric of the investment philosophies across all reporting managers. • This may also be reflective of the influence of early allocators to the asset class being development finance institutions (DFIs) where incorporating ESG as part of the investment thesis was/is a precondition for current and future funding.
Is the fund following, or will the fund shortly be following the most recent version of the International Private Equity and Venture Capital Valuation (IPEV) Guidelines?	• It should be viewed as positive that East African General Partners are adopting or have adopted the IPEV guidelines, as this speaks to broad-based adoption of consistency applied to the valuation process.
Is the fund valued or will the fund shortly be valued by an independent third-party valuation firm?	• In line with IPEV guidelines, the majority of respondents adhere to independent investment valuation.
Does the fund's LP Advisory Board approve or review valuations?	• Best practice would require this important governance function to be undertaken by the representative body of the investors, being much higher across all the General Partners and the industry as a whole.
Are carry payments and carry allocations: independently verified?	• Best practice would require this important calculation to be conducted independently of the GP (ultimate recipient of the calculated Carry).
Are carry payments and carry allocations: independently audited?	• In continuation of best practice principles, the independent audit of carry allocations provides further integrity and assurance to the policies and procedures being used and adhered to by a GP.

3.2.3 Regulatory and Capital Market Authorities

Key Regulatory and Capital Market Insights		Sample response
While Table G[9] can be used as an enabler for greater PE investment, does the regulator have any specific concerns with regards to the private equity industry given that it is:	**1** • Unregulated	• Not really. We understand that it is the nature of the industry, even though we recognise some level of regulation could increase investor confidence.
	2 • Practitioner-driven association through EAVCA is voluntary and not obligatory	• Have not thought much about it.
	3 • Do you have any specific concerns with regards to transparency and disclosure of information to investors, given that investors depend on the General Partners of the private equity funds for information?	• There is always room for improvement. So far, reporting is done based on set RBA guidelines. Reports are developed by fund managers.
As regulator, have you considered the merits and/or grounds for introducing mechanisms that allow for greater transparency with regards to:	**1** • Providing a standardised and industry accepted understanding of fiduciary duty?	• No. If we do it for PE we have to do it for the entire industry.
	2 • Providing clarity (through law) by obliging the partnership agreements to be registered and/or submitted to the regulator, if only to give greater assurance with respect to investor protection?	• The regulator would have to be CMA, as RBA does not have the oversight mandate for fund managers. I do not think this is the reason for less investment in PE though.
As the regulator, would you see merit in setting a rule(s) or limitations where pension funds may only invest in a private equity fund that is a member of EAVCA or an equivalent recognised body?		• Not really since they do not have set laws themselves, it would not matter.
As the regulator, would you see merit in placing specific criteria and/or standards on the experience needed by core members of the GP in order to raise funds from pension funds?		• Some demonstrated experience is definitely helpful.
As the regulator, would you see merit in compelling pension funds to call upon private equity funds to provide independent valuation of their investments as a minimum standard?		• Yes
As the regulator, would you see merit in compelling pension funds (similar to Directive RBA1/12 of 19 March 2018) to seek and procure written independent investment advice prior to investing in a private equity fund?		• Yes

[9] Table G refers to the allowable categories of assets and maximum thresholds as fully described in Legal Notice 107, Retirement Benefits Act (Cap 97) of the Republic of Kenya.

4 Recommendations resulting from the Market Survey Report

Tailored capacity building

Future capacity building initiatives should be tailored for specific stakeholders depending on how the stakeholder interacts with private equity as an asset class. For example:

Capacity building initiatives devised for regulators are likely to have content with greater bias towards discerning the manner in which fiduciaries have developed investment governance policies. The content of such policies should be unambiguous regarding the rationale used by the Trustees in exposing their pension schemes to the asset class and on the implementation and monitoring of such policies.

Capacity building initiatives for Trustees may:

- Have greater focus on how exposure to private equity enhances the overall risk-adjusted returns of their pension scheme within the context of their asset liability framework.
- Formulate a bespoke research, assessment and selection process for specialist private equity managers. There may be a need to review the governance process specific to the decision-making as it relates to private equity, where the Trustees should accept that more time may be required to research the asset class, the funds, and the managers of the asset class, to arrive at well-reasoned investment decisions. This may also involve identifying gaps in knowledge and experience within the Trustee board (in relation to making decisions pertaining to private equity) and in-sourcing the requisite firm(s) or individual(s) able to bridge this knowledge and skills-gap for the scheme.
- Feature an education programme on the development of specialist mandates, given the predominance of balanced mandates within the East African pensions environment.
- Feature a Trustee Certificate of Proficiency in Private Equity Course (for all new Trustees and annually for members of the investment sub-committees of pension funds).

Regulatory oversight and investment governance documentation

- In those jurisdictions where the investment guidelines are not specific with regards to identifying the underlying allowable asset class (e.g. other assets), this must be amended (where applicable) to specifically refer to private equity.
- The asset class requires specialist knowledge to work alongside the drafters of pension fund investment policy statements, so as to capture the bespoke requirements to invest in private equity as an asset class, within the broader investment governance framework of a pension scheme. This may necessitate pension schemes developing and adopting specific investment policies for private equity investing.

- The aspects above speak to the need for a specific governance document that would not only guide the Trustees but also satisfy the regulators that due diligence and the requisite investment governance processes have been adhered to by the Trustees.

Fees

- Greater interaction with the General Partners (life-cycle of an investment decision by the GP), to give Trustees an appreciation of the labour-intensive nature of private equity investing, compared to public equity or public bond investing, should provide better clarity and context on the fees charged by General Partners.

Further research: private equity operates in the real economy

Further studies within each of the East African countries as well as regionally, would be beneficial in placing private equity within the broader micro-economic policy narrative. For example:

- How much have private equity backed businesses contributed to the GDP and taxes of East African countries?
- What has been the cumulative job creation (pensions contribution) of PE backed business within East African countries?
- What has been the revenue and profitability growth of PE-backed businesses compared to those of listed companies?

5 Conclusion

In East Africa, private equity as an asset class is receiving greater focus from East African pension schemes as they look to achieve further diversification within their investment portfolios. This report provides context to the decision matrix faced by pension scheme trustees when considering an allocation to private equity as an asset class. Importantly, the Report affirms the continued need for specific tailored education of pension scheme trustees to enable them to adjudicate prudently when investing in the asset class, as well as the on-going monitoring and evaluation of their investment decision.

The absence of an applicable (East Africa) private equity risk and return benchmark has been cited as an important limiting factor. While this contention is largely valid, due consideration should be given to the fact that in East Africa, most private equity funds are now approaching the harvesting of their initial funds. The true performance of private equity funds can/will only be judged at the end of each fund life, when all investments are liquidated.

We note that the majority of General Partners are, or have integrated ESG as part of their investment decision-making. Not only will this investment methodology provide for long-term and sustainable investment allocations, ESG investment also provides alignment and congruence in the expectations of the General Partner (private equity asset managers), investee company and the Limited Partner (pension funds).

The provision of long-term capital to private equity funds presents an opportunity for East African pension schemes to have direct equity exposure to their respective ‘real economies’. The investment thesis of private equity and venture capital supports entrepreneurship; importantly, the investment cycle of the asset class provides for patient capital, necessary for sustainable growth of investee companies, despite periods where the macro-economic environment may prove to be unsupportive. Having said this, pension fund trustees should appreciate the fact that private equity investing is opportunistic; thus certain industry sectors may be over, or underweight depending on the economic cycle and the growth dynamics within each sector.

Annexure A
Pension Scheme Case Study, Kenya Power

<table>
<tr><th>Question</th><th>Answer</th></tr>
<tr><td>1. Which private equity funds have you committed to?</td><td>Ascent Rift Valley Capital
Fanisi Fund II
Catalyst Fund II</td></tr>
<tr><td>2. What was the size of the commitment to each PE fund?</td><td>Ascent Rift Valley Capital: $4m
DB Scheme: $2m
DC Scheme: $2m

Fanisi Fund II: $4m
DB Scheme: $2m
DC Scheme: $2m

Catalyst Fund II: $4m
DB Scheme: $2m
DC Scheme: $2m

*DB = Defined Benefit Scheme
*DC = Defined Contribution Scheme</td></tr>
<tr><td>3.PE allocation as a percentage of total pension scheme value as at 31 December 2018?</td><td>DC Scheme: 1.4%
DB Scheme: 1.1%</td></tr>
<tr><td>4. What exit options have been considered and discussed with the PE Funds?</td><td>
<table>
<tr><th>PE fund</th><th>Exit option(s) discussed at commitment</th><th>Current position</th></tr>
<tr><td>Ascent Rift Valley Capital</td><td rowspan="3">• Trade and strategic sales
• Sell back to owner
• Initial Public Offer (IPO)</td><td>Ongoing strategic assessment</td></tr>
<tr><td>Fanisi Fund II</td><td>Ongoing strategic assessment</td></tr>
<tr><td>Catalyst Fund II</td><td>Ongoing strategic assessment</td></tr>
</table>
</td></tr>
<tr><td>5. Exit IRR discussed with the PE Funds?</td><td>
<table>
<tr><th>PE Fund</th><th>Exit IRR discussed</th></tr>
<tr><td>Ascent Rift Valley Capital</td><td>Gross IRR: 25%
Net IRR: 18%</td></tr>
<tr><td>Fanisi Fund II</td><td>Gross IRR: 25% - 35%
Net IRR: 15% - 20%</td></tr>
<tr><td>Catalyst Fund II</td><td>Gross IRR: 30%
Net IRR: 15%</td></tr>
</table>
</td></tr>
</table>

Annexure B
Glossary of Key Terms

Key Terms	
Limited Partner	The investors in a limited partnership. Limited partners are not involved in the day-to-day management of the partnership and generally cannot lose more than their capital contribution.
General Partner	The managing partner in a private equity management company who has unlimited personal liability for the debts and obligations of the limited partnership and the right to participate in its management. The General Partner is the intermediary between investors with capital and businesses seeking capital to grow.
Drawdown	When used by an investor, this is the total amount of committed capital that has been requested by its private equity funds. When used by a fund, this is the total amount of committed capital that it has drawn down from its investors.
Commitment	Resources flowing from an institutional investor to the private equity fund(s).
First Closing	An early close of part of a round of financing upon the agreement of all parties.
Final Closing	The final close of part of a round of financing upon the agreement of all parties.
Distribution	Cash and/or securities paid out to the Limited Partners from the Limited Partnership.
Carried Interest	A bonus entitlement accruing to an investment fund's management company. Carried interest becomes payable once the investors have achieved repayment of their original investment in the fund, plus a defined hurdle rate, if applicable.

Source: ILPA

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