

## TERMS OF REFERENCE

### Consultancy Service to Develop an Investment Strategy for Pension Funds in support of the Ministry of Finance, Ethiopia

<b>Project Name</b>	<b>Developing Investment Strategy for Pension Funds</b>
<b>Location</b>	Addis Ababa, Ethiopia
<b>Procurement Type</b>	Firm level consultancy services open for international firms.
<b>Expected Start Date</b>	To be determined
<b>Duration</b>	4 Months

#### 1. Introduction

FSD Ethiopia wishes to engage a consultancy firm to support the Ministry of Finance in developing an investment strategy and building capabilities of fund administration agencies.

The Investment Strategy is expected to present market investment opportunities for the pension funds, identifying selected asset classes and types, establishing the principles for investment, risk management and portfolio diversification and management approaches. It should also flesh out paths for the gradual diversification of the fund's investment portfolio considering the national macroeconomic environment and market opportunities.

The strategy will also design the investment governance structure, including establishing an investment committee comprised of experts to support the Board and develop a clear investment. In addition, it will explore domestic opportunities, including treasury bonds, fixed deposits, real estate, equities, and infrastructure.

#### 2. Background

##### 2.1 About FSD Ethiopia

FSD Ethiopia is an agency that aims to support the development of accessible, inclusive, and sustainable financial markets for economic growth and development.

Our role is to identify the underlying causes of financial system failures, facilitate market actors to address these constraints, and help build a functional and effective financial sector that generates economic gains for a wide cross-section of Ethiopian individuals and businesses. We provide technical assistance, grants, and research insights to policymakers, regulators, and market actors. Our vision is to contribute to a thriving financial system that delivers real value to the broader economy and the people of Ethiopia.

FSD Ethiopia is providing multiple support facilities in Ethiopia including the establishment of Capital Markets and the implementation of financial inclusion programs in line with the Government's objectives, priorities, and strategies.

FSD Ethiopia is incubated by FSD Africa, and it is funded by UK aid from the UK government and the Bill and Melinda Gates Foundation.

## 2.2 Pension Fund Transformation Initiative

Ethiopia has public and private pension schemes covering close to 4.5 million individuals, governed by different entities but generally following the same overarching structure. The Public Servants Social Security Agency (PSSSA) manages the public-sector pension scheme. It covers citizens of Ethiopia employed in the public sector, including political appointees and the military.

The private-sector pension scheme is governed by the Private Organization Employees' Social Security Agency (POESSA). It covers citizens of Ethiopia employed in the private sector while being voluntary for those self-employed. The funds come from direct deductions of the monthly payroll of employees and direct contributions by employers.

The pension schemes in Ethiopia follow a defined benefit structure, calculated as a percentage of the average monthly salary for a period preceding retirement or disability. The current age for standard old-age retirement is 60 (for the private sector and public servants, lower for the military and police), with options for early retirement under circumstances of extended service.

Pension schemes are part of Ethiopia's social policy that aims to expand the social security of its citizens. Pension funds are also considered a crucial part of the financial sector and play a significant role in growing the economy, providing much-needed patient capital to stimulate growth.

The Pension schemes are designed to provide the public with two primary functions: to furnish a saving mechanism and to alleviate poverty among the old through the provision of income payments on retirement to make consumption flow. The government policy also recognizes the need for a well-functioning pension scheme and considers it a significant contributor to social justice, industrial peace, and poverty reduction. This is particularly important considering the million people who will begin to retire in the coming few decades.

### The current state of the Pension Funds Administration

- **Management of pension funds is rudimentary**, and it is unable to fulfil its purpose and overall objective of a social protection instrument for citizens. Failure to have a well-functioning pension fund administration could have profound implications for the ability of the pension scheme to fulfil its current and long terms obligations.
- **Pension funds raised from contributions are mainly invested in government Treasury bills.** Before the reforms introduced in 2020, the gains from these investments had been minimal and often resulting a negative real return on investment at (~ 13% over the last decade, while the average inflation rate is around 18%).
- **The mandate of the pension schemes is unclear, and investment practices have deprioritized financial returns** and income generation for the funds. This narrow investment philosophy limits the ability to achieve optimal returns and create value for beneficiaries, e.g., the annual indexation of funds to inflation would be challenged to be sustainable.
- **The investment portfolios face a concentration risk due to low diversification, with 100% of the investment allocated to fixed-income assets.** Non-treasury bill asset classes such as bonds, stocks, property, loans, and foreign assets are not being considered. Neither has been

any private sector investment, thereby limiting liquidity provision to the Financial Market in general and limiting access to capital within the broader economy.

The pension scheme needs to adapt to the country's rapid economic and social development and benefit the citizens through expansion of the system, consolidation, and efficient management of resources.

In 2020, The Ministry of Finance, in coordination with the PSSSA and POESSA leadership, undertook an in-depth diagnostic of the pension funds, including financial sustainability, organizational structure, and capabilities, with the technical support of McKinsey. The assessment included a review of the economic sustainability, investment returns and management, and institutional mandate and capabilities of the Pension Fund Administration.

The latest actuarial study of the two funds (July 2020) presented that the public and private pension funds are broadly sustainable until 2060 and 2070, respectively. At the same time, the assessment has highlighted concerns over the erosion of the funds due to rapid inflation, poor asset diversification, and the inadequacy of benefits to protect pensioners' welfare.

Following the diagnostics assessment and recommendations, the Government has taken concrete steps that signal its commitment to the pension fund reform agenda reflected in the enactment of Pension Funds Proclamations (1267/2022 and 1268/2022) by the House of Parliament.

Key changes implemented as a result of the recommendations included: Provision of an investment mandate to the boards (Transferred from the Ministry of Finance to Boards), moving the supervision of the funds from the Ministry of Labor to the National Bank of Ethiopia and allowing independent human resource administration (a departure from civil service laws),

In line with the economy-wide reforms and the opportunities the pension funds present to contribute to financial sector development, the Ministry of Finance is implementing a pension fund transformation program to develop the capabilities for 1) pension investment reform to improve the returns from funds, 2) organizational improvements including digitalizing core processes, improving data quality, and management, 3) adjusting the organizational structure and securing the right capabilities, and 4) improving the coverage of pensions to private sector employees.

### **3. Scope of the work**

FSD Ethiopia is looking to contract a Service provider to support the ministry of Finance and pension fund administration agencies in developing an investment strategy for managing pension funds and building the capability of pension fund administration agencies.

The core objective of this Project is to Improve the risk-adjusted returns on investment with appropriate consideration of the dual mandate of the funds for bringing developmental and financial returns.

The Investment Strategy should seek to present market investment opportunities for the pension funds, identifying selected asset classes and types, establishing the principles for investment, risk management and portfolio diversification and management approaches. It will flesh out paths for the gradual diversification of the fund's investment portfolio in light of the national macroeconomic environment.

The strategy is also expected to cover the investment governance structure, including establishing an investment committee comprised of experts to support the Board and develop a clear investment. In addition, it should explore domestic opportunities, including treasury bonds, fixed deposits, real estate, equities, and infrastructure.

### **Expected Outputs**

**Developing an investment strategy:** design the investment strategy, including the investment philosophy (what the schemes can invest in), defining clear targets for risk-adjusted returns, investment portfolio, and an asset allocation plan for the investable asset classes. It will also include a scenario exercise for investment decisions and future changes to the investment strategy.

**Building Investment capabilities:** Technical Support to the pension fund administration agencies to establish internal and external investment functions and teams to execute the investment strategy.

The Ministry of Finance will be the lead coordinating and oversight body for implementing this intervention. At the same time, the Pension Fund Administrative Agencies (PSSSA and POESSA) will be essential implementing partners and beneficiaries. Following the recent change in governance structure, the National Bank of Ethiopia will also be involved in implementing the Project.

## **4. Methodology**

The Consultant should propose their own methodology for this assignment in line with the expected scope of work and deliverables. The approach should be convincingly and clearly laid out in the bidder's proposal and must address the Scope of Work above.

## **5. Deliverables**

Working in collaboration with the project steering committee led by the Ministry of Finance, the Consultant is required to deliver the following outputs:

- An inception report with a clear delivery methodology, a stakeholder engagement plan, a delivery plan, and timelines. The inception report may be based on desk research and initial stakeholder conversations.
- A draft Investment strategy report that addresses all the component stated in the scope of work for each of the regions.
- Presentation of Findings in the form of a validation workshop to key stakeholders.
- A Final Investment Strategy incorporating feedback from validation workshop with key stakeholders, including detailed implementation plan and project initiatives to improve financial inclusion.
- Investment capability plan that outlines the required structure, resources, capacity needs and work process to identify, appraise and make investment decisions.
- Delivery of capacity-building activities through training, workshop and other modalities to the pension fund administration agencies.

All deliverables shall be provided in editable formats, including word format, Excel formats and in PowerPoint format for presentations.

## 6. Ways of working

The Consultant will be contracted by FSD Ethiopia and closely work with the assigned project lead and project steering committee that is led by the Ministry of Finance and composed of other stakeholders relevant to the work.

## 7. Timelines

The Project is expected to be completed in 4 months duration. See below an indicative timeline for key deliverables.

No	Deliverable	Timeline for Phase I
1	Inception report	Day 15
2	Draft Investment strategy	Day 60
3	Final Investment Strategy	Day 80
4	Investment capability building plan	Day 90
5	Delivery of capability building activities	Day 120

## 8. Eligibility Requirements

- International consultancy firm with experience in the Ethiopian context.
- Proven experience in developing investment strategy. Having a previous engagement in the development of investment strategy of pension funds in other countries is advantageous.
- Deep understanding of pension fund administration is required.
- Willingness and ability to commit senior level involvement throughout the project implementation.
- Willingness to provide at least one representative available locally in person throughout the project.

Working in developing countries; sub-Saharan Africa and Ethiopia in particular.

## 9. Invitation to Submit Proposal

FSD Ethiopia is inviting proposals from suitably qualified service providers.

The proposal should contain:

- A description of the Consultant's understanding of the context, objective and purpose of the assignment as outlined in these terms of reference and their role in fulfilling this objective.
- A detailed description of the qualifications and professional experience of the Consultant, including an explanation of the transferrable skills and experience relevant to this assignment, A professional CV, along with their roles and expected allocation of time.
- A minimum of two references (and their contact details) who can provide testimony for the Consultant's experience, skills, and overall suitability for this assignment highlighting experience relevant to this RFP and dates of service.
- An indication of the expected remuneration, incl. any relevant details on reimbursable expenses, taxes, etc.
- A detailed description of the methods that will be used to carry out the assessment and draft action framework.

- A list of deliverables and outputs that you will provide, including draft and final reports.
- A proposed project timeline, including milestones for each deliverable required.
- Contact details for the primary reference person at your organization for this RFP.
- A summary of how the service provider meets the skills and qualifications, any unique capabilities of your team/organization that are relevant to this Project, and previous experience working with the foundation.

Proposals should be submitted by email to [bids@fsdafrica.org](mailto:bids@fsdafrica.org) by **1200hrs (EAT) on 15<sup>th</sup> February 2023** under a subject line reading 'Proposal: Ethiopia Pension Fund Investment Strategy'.

## 10. Basis of Award

FSD Ethiopia will award a contract to the consultant based on the following criteria:

Assessment Criteria	Weighting (%)
Relevant, demonstrated experience and capacity of the proposed team in this area	40%
Understanding/interpretation of the task set out in the TORs	40%
Fee basis and total costs $FS = 20\% \times LB/BP$ where: FS = is the financial score LB = is the lowest bid quoted BP= is the bid of the proposal under consideration. The lowest bid quoted will be allocated the maximum score of 20%. The price quoted must be inclusive of all applicable taxes	20%
<b>Total</b>	<b>100%</b>

## 11. Financial Proposal

- 12.1 An itemized budget for both professional fees and reimbursable expenses, including fee rates, number of days and a breakdown of expenses a required.
- 12.2 Consultant should submit their financial proposal categorized for Phase I and phase II separately and as overall total.
- 12.3 As per Ethiopia's tax law, FSD Ethiopia will pay the contractor after withholding the appropriate taxes at the applicable rate. It is the responsibility of the contractor to keep themselves apprised of these applicable taxes.

## 12. Contact

Questions or comments in respect of these terms of reference should be directed by email to: [bids@fsdafrica.org](mailto:bids@fsdafrica.org) on or before **12 noon 6<sup>th</sup> February 2023** and feedback will be provided **by 5 pm (EAT) 10<sup>th</sup> February 2023**.

### Annex 1: Proposed Fee Schedule

Costs should be shown separately in the format set out below. Fees proposed by tenderers should be inclusive of all taxes.

Consultancy Fees*	Days/ Months/Units	Fee in ETB/USD	Total ETB /USD
XX			
XX			
XX			
Total Remuneration cost			
Reimbursable costs**	Unit	Fee in ETB/USD	Total ETB /USD
XX			
XX			
XX			
Total Remuneration cost			
<b>Total proposes Cost</b>			
*Fees Include all taxes			
** Expenses to be reimbursed on actual costs as per FSD Ethiopia policy			