MAY 2020

In case you missed it…

- April 2020: Seshego Insights National Budget 2020 – Effect on Retirement Funds and their members
- March 2020: Seshego Legal Insights: The Five Coronavirus Shocks - Old Mutual Multi-Manager
- Special: Seshego Legal Insights: Your Retirement Fund And The Covid-19 Virus (Corona Virus)
- February 2020: Seshego Legal Insights

Prescribed assets revisited

What a difference a quarter makes. At the beginning of 2020 the discussion around prescribed assets was a euphemism for a savings tax. Government support for prescribed assets in retirement funds seemed to be growing and retirement fund investors feared they would be forced to bail out Eskom, or even worse SAA!
The fear was that the government would add to the existing rules that limit retirement funds' offshore investments to 30%, limit the exposure to shares to 75%, and a raft of other limitations known as the "prudent investment guidelines" or Regulation 28.

If the government required that funds invest, say, 40% in government assets such as government bonds and state-owned enterprises (SOEs), this could be a quick-fix for bailing these SOEs out, and potentially lowering the cost of government debt in the face of the last remaining ratings agency downgrade to "junk status". Prescribed assets could also help the state avoid approaching the International Monetary Fund (IMF) for a bailout.

A quarter later approaching the IMF (or similar body) for a bailout seems a *fait accompli* after the ANC's NEC meeting on 7 May, and the politicians are merely debating what terms the IMF may be allowed to impose so as not to compromise the country's sovereignty - read that to mean taking certain decisions out of the politicians' hands.

Depending on your perspective, taking decisions on issues such as the level of the public sector wage bill out the politicians' hands may be a good thing?

Prescribed assets are not a new concept, and the apartheid government forced retirement funds to invest in government assets. The resulting cash was used to invest in infrastructure and various other National Party objectives. This meant that there was less capital available for private sector investment, and in turn retirement funds did not earn the best possible returns. The difference between then and now is that previously most companies had defined benefit funds, whereas now almost all retirement funds are defined contribution funds. What this means is that previously the investment risk and reward fell on the employers, but now this is borne by the retirement fund savers.

> With evidence on the state of government over the past decade emerging, it seemed intuitive that prescribed assets would be a bad thing for retirement fund savers. Telling people how to invest would be a distortion of the capital market.

Prescribed assets are not unique to South Africa. There have been some disastrous cases such as Egypt, Nigeria, Zambia and Ghana, but there have also been the likes of Singapore, Malaysia and Sweden where the effect on investment returns was minimal and the introduction of prescribed assets resulted in a massive change in the economy of these countries. These success stories used prescribed assets wisely to invest in infrastructure and development. If these countries could be emulated, it would make sense to help South Africa through a difficult period of low growth, high unemployment, and high inequality after the country's fiscus had been laid bare after an estimated R1 trillion heist.

Andrew Cantor, CIO of Futuregrowth, says

"There are two assumptions underneath the concept of prescription. The first assumption is that the problem is a shortage of money for development. That is absolutely untrue. South Africa has a large capital market, a large savings industry. If the government brings in intelligent, sustainable SOEs with developmental projects, there is plenty of money to fund it. The second assumption – under prescription – is that if we don't force pension funds to do it, they won't do it. That is utter rubbish. We've been doing development investment for 25 years – we've never had a shortage of money."

The lack of credible development investments may explain why after the retirement funds conference of 2002, where the stakeholders agreed that retirement funds should invest 5% in infrastructural development assets, nothing happened.

A quarter later we sit staring down the barrel of an economic depression, the scale of which is being compared to the Great Depression of 90 years ago. The first week of May 2020 saw Business for South Africa (B4SA) release economic projections indicating that if the South African economy is not reopened soon, the economy is estimated to contract by 17% this year. Put into perspective, at previous (positive) growth rates, this year's economic decline alone will take two generations to recover! Facing this frightening prospect, the debate starts to shift away from why South Africa can never emulate Singapore, Malaysia or Sweden to how investment in South African infrastructure can be made whilst minimising the influence of certain kleptocratic overseers of public policy.

Actuary, Anthony Lester, writes

"successful countries seek to operate in the narrow corridor where there is a balance between the interests of government and civil society. A pre-requisite to get into the narrow corridor is that the two parties seek "win-win" solutions.

For instance, a much better outcome is possible if government and institutional investors work together to facilitate the latter's investment into infrastructure assets versus the alternative of government imposing prescribed assets. Furthermore, some of the assets of the Government Employees Pension Fund can be allocated for development objectives. Naturally, civil society has an obligation to ensure that all this money is well-spent to foster economic growth so that future taxpayers are able to repay the money.

In addition, one of the "quid pro quos" that could be considered for institutional and retail investors is that in exchange for investing in domestic infrastructure and other development programmes these entities could be allowed to invest more offshore. The additional offshore allowance could be determined by counting investment in companies that have their primary listing offshore as foreign exposure. Let's say such companies constitute 20% of the index, then South African institutional investors could invest 50% offshore (30% plus an additional 20%) and to the extent that they decide to invest in the likes of Richemont, BHP, Anglos and British American Tobacco this will count as part of the 50% offshore. Such a simple change would allow local investors to build far more diversified portfolios and exploit a wider opportunity set."