JULY 2022: EDITION 6 of 2022

REVISED REGULATION 28 OF THE PENSION FUNDS ACT - FINALISED

In case you missed it…

1. Background

The long-awaited changes to Regulation 28 of the Pension Funds Act ("Regulation 28") have now been finalised and gazetted, following comment from the industry which was duly considered by National Treasury. These amendments significantly impact the investment environment and boards of trustees need to be aware of the effect of the changes when determining the investment strategy for their retirement fund.

The amendments to Regulation 28 will come into effect on 3 January 2023 to enable regulators and fund managers to comply with the new requirements.

2. What are the changes to Regulation 28?

2.1 National Treasury has stated that it aims to explicitly enable and encourage longer term infrastructure investment by retirement funds, by increasing the maximum limits that funds may invest in infrastructure. Infrastructure has now been recognised as a separate asset class and accordingly:

- A definition of infrastructure has been added

"**infrastructure** means any asset that has or operates with the primary objective of developing, constructing and/or maintaining physical assets and technology structures and systems for the purpose of utilities, services or facilities for the economy, businesses or the public";

- Exposure to infrastructure investment has been limited to an overall investment limit of 45%. This high limit currently poses liquidity questions when setting an Investment Policy Statement, if fully utilized, but as the "Two-Pot" system phases in compulsory preservation, this liquidity risk will become less of an issue.

IMPORTANT: *The 45% is the prescribed limit of exposure to investment in infrastructure development. This investment is discretionary and not compulsory for funds to invest a portion of their assets in infrastructure.*

2.2 The current limit between hedge funds and private equity has been split. The allocation to investment in private equity assets has been raised and is now 15% instead of 10%. The limit for investment in hedge funds is 10%. However, only investment in hedge funds approved by the Collective Investment Schemes Act is permissible, which provides an additional layer of protection to investors.

2.3 A limit of 25% has been imposed across all asset classes to limit exposure of retirement funds to any one entity or company, not just infrastructure. One exception to this limit is any debt instrument issued by and loans to the Government of South Africa and any debt or loan guaranteed by the Republic of South Africa.

2.4 Investment in crypto currency is completely prohibited. A definition of a crypto-asset has been added for clarity:

"**crypto-asset** means a digital representation of value that is not issued by a central bank but is capable of being traded, transferred or stored electronically by natural and legal persons for the purpose of payment, investment and other forms of utility by applying cryptographic techniques and uses distributed ledger technology."

The reason for this is to protect retirement fund members from the market volatility and the potential loss that can result from investment in crypto currencies. Investment in the underlying technology is not necessarily precluded by this definition.

*2.5 **Importantly,** the asset allocation to housing loans granted to retirement fund members has been reduced from 95% to 65%. Note that this applies only to new members. National Treasury has become concerned about potential abuse of the housing loan facility by fund members and the reduction is aimed to prevent this. However, National Treasury have said that they are mindful of the important role played by housing ownership in wealth creation and in retirement and will continuously monitor this area of investment.*

2.6 It should also be noted that the reporting exclusion on collective investment schemes and insurance policies has been removed, which will require funds, administrators and investment managers to provide more information on the underlying investments. The reason for this is to equip the regulatory authorities with the information needed to enable them to effectively monitor and supervise retirement fund investing.

3. What are the main implications for retirement funds?

3.1 Regulation 28 aims to protect retirement fund savings by limiting the extent to which funds may invest in a particular asset or in particular asset classes, with the objective of preventing excessive concentration risk. The intention of Regulation 28 as stated in the preamble is that retirement funds must invest prudently and responsibly – hence the absolute prohibition on investments in crypto currencies. The proposed changes are in line with these objectives.

There are those that argue that the limit on equities is undermining of long-term retirement objectives, but in reality the limits allow for a high exposure to "growth assets" across the various asset limits. Significantly, the South African Reserve Bank has lifted the offshore exposure, which now includes investments in Africa, to 45% after the February 2022 National Budget.

3.2 The amendments to Regulation 28 also provide clarity in that terms such as "crypto-assets", "hedge-fund" and "infrastructure" are now defined.

3.3 There are practical implications for boards of trustees, who will need to:

- Check their housing loan contracts and fund rules and, if necessary, amend these to reflect the reduced amount that may be allocated for housing purposes;

- Review their investment strategy and update their their Investment Policy Statement if they intend to make any changes to reflect the new limits permissible in terms of revised Regulation 28.

Given the concerns around the possible introduction of prescribed assets, we highlight that the current policy is for Regulation 28 to encourage investment in infrastructure but does not make it compulsory for any retirement fund to invest assets in this category. National Treasury have stated that the final decision on any investment will still be made by the board of trustees of the retirement fund who determine the investment policy of the fund, on the basis of what is appropriate for its membership.