New Reg 28 and what we’ve learnt so far

Johan Schreuder

Investec Asset Management
Context

• Regulation 28 of the Pension Funds Act

• Regulates the investments allowed by SA retirement funds
  • By implication, determines the limits on many of our pooled funds

• Promulgated in the 1950s and last reviewed in 1998

• Was in serious need of an update, for example
  • silent on derivatives
  • limited foreign exposure to 15%
  • allowed investment in now defunct entities
Agenda

1. Context
2. Consultation process
3. Biggest wins for retirement funds
4. Biggest challenges for the industry
5. Board Notices published and outstanding
6. Regulating the use of derivatives
7. Conclusion
Consultation process

- National Treasury published Draft 1 in February 2010
  - The Actuarial Society submitted extensive comments
  - Technical drafting committee with NT, the FSB and others
- National Treasury published Draft 2 in December 2010
  - Much better but still a couple of major issues
    - The Actuarial Society again submitted extensive comments
    - Together with ASISA, SAVCA, the IRF and others
- Final version published 23 February 2011, effective 1 July 2011
Comments from the Actuarial Society

- Prudential regulations ideally need to be principles-based
- Retirement funds face different investment risks
  - Limits can deal with concentration, credit and currency risk
  - But limits can aggravate inflation risk and interest rate risk
  - Volatility and liquidity risk less important given long-term nature
- Aligning with similar regulations should not be done blindly
- Any significant changes need to be phased in over time
- 23 of our 40 detailed comments were accepted & incorporated
Members who contributed

- Thank you!

- Investments Committee
  - Deon Hugo
  - Edru Ochse
  - Johan Schreuder
  - Nicky Holtzhausen
  - Vincent Heys

- Retirement Matters Committee
  - Gavin Finch
  - Mike Codron
  - Selwyn Feldman
  - Tommie Doubell
  - Zaheer Bhikha

- Also consulted with the Life Assurance Committee and others
Biggest wins for retirement funds

- Foreign limits removed from the regulation
  - Allowing alignment with Excon, currently 25% + 5% extra Africa
- The limit on listed debt issued by banks increased significantly
  - As did the limit on listed debt issued by listed corporates
- Commodities recognised as an asset class with a 10% limit
- Hedge funds recognised as an asset class with a 10% limit
- Private equity recognised as an asset class with a 10% limit
## How the limits have changed 1

<table>
<thead>
<tr>
<th>Asset class</th>
<th>Old</th>
<th>Draft 2</th>
<th>New</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Debt</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Equity</td>
<td>75*</td>
<td>75</td>
<td>75</td>
</tr>
<tr>
<td>Property</td>
<td>25*</td>
<td>25</td>
<td>25</td>
</tr>
<tr>
<td>Commodities</td>
<td>10</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Other</td>
<td>2.5</td>
<td>15</td>
<td>15</td>
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</tbody>
</table>

* Counts towards 90% maximum on volatile assets
### How the limits have changed 2

<table>
<thead>
<tr>
<th>Asset class</th>
<th>Sub-limits</th>
<th>Old</th>
<th>Draft 2</th>
<th>New</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td></td>
<td>SA banks</td>
<td>20 / 100</td>
<td>25 / 100</td>
<td>25 / 100</td>
</tr>
<tr>
<td></td>
<td>Foreign banks</td>
<td>15 / 15</td>
<td>5 / …</td>
<td>5 / …</td>
</tr>
<tr>
<td>Debt</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>SA government</td>
<td>100 / 100</td>
<td>100 / 100</td>
<td>100 / 100</td>
</tr>
<tr>
<td></td>
<td>SA banks</td>
<td>10-25 / 75</td>
<td>5-25 / 75</td>
<td></td>
</tr>
<tr>
<td></td>
<td>SA parastatals</td>
<td>20 / 100</td>
<td>5 / 25</td>
<td>5-10 / 50</td>
</tr>
<tr>
<td></td>
<td>Listed issuers</td>
<td></td>
<td></td>
<td>5-10 / 50</td>
</tr>
<tr>
<td></td>
<td>Foreign governments</td>
<td>15 / 15</td>
<td>10 / …</td>
<td>10 / …</td>
</tr>
<tr>
<td></td>
<td>Other incl. unlisted</td>
<td>5 / 25</td>
<td>5 / 25*</td>
<td>5 / 25*</td>
</tr>
</tbody>
</table>

* Counts towards 35% maximum on unlisted assets
## How the limits have changed

<table>
<thead>
<tr>
<th>Asset class</th>
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<th>New</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Equity</strong></td>
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<tr>
<td></td>
<td>Large-cap listed</td>
<td>15 / 75</td>
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<td>15 / 75</td>
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<tr>
<td></td>
<td>Mid-cap listed</td>
<td>15 / 75</td>
<td>10 / 75</td>
<td>10 / 75</td>
</tr>
<tr>
<td></td>
<td>Small-cap listed</td>
<td>10 / 75</td>
<td>5 / 75</td>
<td>5 / 75</td>
</tr>
<tr>
<td></td>
<td>Unlisted</td>
<td>5 / 5</td>
<td>2.5 / 10*</td>
<td>2.5 / 10*</td>
</tr>
<tr>
<td><strong>Property</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Large-cap listed</td>
<td>5 / 25</td>
<td>15 / 25</td>
<td>15 / 25</td>
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<tr>
<td></td>
<td>Mid-cap listed</td>
<td>5 / 25</td>
<td>10 / 25</td>
<td>10 / 25</td>
</tr>
<tr>
<td></td>
<td>Small-cap listed</td>
<td>5 / 25</td>
<td>5 / 25</td>
<td>5 / 25</td>
</tr>
<tr>
<td></td>
<td>Unlisted (i.e. direct)</td>
<td>5 / 25</td>
<td>5 / 15*</td>
<td>5 / 15*</td>
</tr>
</tbody>
</table>

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</tr>
</thead>
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<tr>
<td><strong>Commodities</strong></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Kruger Rands</td>
<td>10 / 10</td>
<td>10 / 10</td>
<td>10 / 10</td>
<td></td>
</tr>
<tr>
<td>Other listed</td>
<td>10 / 10</td>
<td></td>
<td>5-10 / 10</td>
<td></td>
</tr>
<tr>
<td><strong>Other</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hedge funds</td>
<td>2.5 / 10*</td>
<td>2.5 / 10*</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Private equity funds</td>
<td>2.5 / 10*</td>
<td>2.5 / 10*</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td>2.5 / 2.5</td>
<td>2.5 / 5*</td>
<td>2.5 / 2.5*</td>
<td></td>
</tr>
</tbody>
</table>

* Counts towards 35% maximum on unlisted assets
Biggest challenges for the industry

- Includes a number of softer principles
  - which are hard to measure and impractical for retail funds
- Requires compliance at member level
  - for example where funds offer life-staging or member-choice
- Requires look-through for CIS funds and investment policies
- No longer allows automatic exemption for “guaranteed” policies
- Reduces the limit on direct property
  - which is now recognised as unlisted and illiquid
Measuring up to the softer principles

• Assets appropriate for liabilities

• Professional investment process
  • Sustainable performance, incl. environmental, social & governance
  • Consider risk, incl. credit, market, liquidity and operational risk
  • For foreign investing also consider currency and country risks
  • Credit ratings important but not to be relied upon in isolation
  • Understand the changing risk profile of assets over time

• Licence to operate
  • Education, compliance of service providers, promote BBBEE
Look-through and the role of IMLs

- Continuous look-through compliance, at member level
- Significant challenge for open-architecture retail funds
- But CISCA can be relied upon to an extent, given lower limits
- Intended Maximum Limits (IMLs) developed to fill the gaps
  - Foreign, equity and property IMLs available for most CIS funds
  - Other IMLs may be added if the need arises
- Most open-architecture funds use IMLs on switches & additions
- Many intend to use actual look-through data at quarter-ends
Member- vs. contract-level compliance

- Reg 28 (3) (c) quite hard to understand

- Grandfathering of existing member-level arrangements

- But full compliance required on switches and additions
  - “... including where an additional amount over and above any regular contractual premium or contribution is contributed to the policy or arrangement ...”

- Can members enter into new arrangements with same fund?

- Thereby grandfathering existing arrangements forever?
Board Notices 1 & 2

• Board Notice 1
  • Transition period until 31 December 2011
  • During which time investments may not become less compliant
  • Note that new Reg 28 was still effective 1 July 2011

• Board Notice 2
  • Exemption from the requirement to report breaches immediately
  • Instead, funds must report breaches per calendar quarter
  • Within 30 days following the reporting quarter
  • With the first reporting quarter being January – March 2012
Board Notices outstanding

• “... subject to conditions as may be prescribed.”
  • Derivative instruments*
  • Hedge funds
  • Non-linked insurance policies
  • Private equity
  • Securities lending*

• * Certain drafts were issued in July 2011
  • Actuarial Society submitted comments on the use of derivatives

• Final Board Notices still outstanding
Regulating the use of derivatives

- Both economic & counterparty exposure subjected to limits
- Long positions should be covered by appropriate assets
- Long and short positions should be netted appropriately
- As a rule, short positions should be covered by matching longs
- Certain short positions can be covered by similar longs
- Short bond positions where used for duration management
- Short bond positions where used for liability management
Conclusion

1. Good process from National Treasury and the FSB
2. Sincere appreciation for the Actuarial Society’s contributions
3. Definite move towards principles, but clearly not yet fully there
4. Some new investment opportunities for retirement funds
5. Significant challenges for the industry
6. Pragmatic solutions are being found
7. We eagerly await the final Board Notices
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