Compulsory asset spread protects your retirement bread

By Michael Jackson



Regulation 28 of the Pension Funds Act has been designed so that retirement fund members are protected from their funds and from themselves.

Introduction

In recent times, government has expressed its concern that South Africans are not saving and making adequate provision for retirement. Minister of Finance, Pravin Gordhan, addressed this issue in both his 2013 and 2014 budget speeches. Government is in the process of introducing reforms to the retirement fund industry, amongst which are changes to the manner in which retirement funds are governed, the taxation of retirement funds and the preservation of retirement savings of individuals (Gordhan 2013; 2014).

Government recognized that these reforms would be meaningless if there were no protection of assets or funds once the fund member's money was inside a particular retirement fund. It goes without saying that, if an investor's funds are invested on a platform which is, for example, equity-heavy, then a stock market crash shortly before retirement could leave that investor much worse off than had no crash occurred. This article contains a general overview of Regulation 28 of the Pension Funds Act which sets out the measures that were effected to ensure that retirement fund members enjoy protection while belonging to the fund.

Context

Regulation 28 is a regulation attached to the Pension Funds Act 24 of 1956 and adherence thereto by both individual retirement fund members and retirement funds themselves is obligatory (PPS Investments 2012). This is conveyed in the language used in clauses 2(a) and 3(a) of the regulation, where it is stated that all funds 'must comply' with the regulation (Pension Funds Act 1956).

Substance and need

Regulation 28 serves as a guideline (a compulsory one) for retirement fund trustees and it places upper limits on the allocation of assets within the constitution of both the retirement fund as a whole, and each member's individual share, specifically. The regulation was necessitated by the need to protect both retirement funds and its members from irresponsible allocation of their investments (see the preamble to the regulation) (Swanepoel 2013:165 -166).

When did it take effect?

The regulation is not a new phenomenon to the South African retirement domain. It had its roots in notices published as far back as 1989. The regulation being referred to in this article is, in fact, the revised regulation and it took effect on 1 July 2011. The Registrar of Pension Funds, however, had allowed funds and individuals until 31 December 2011 to comply (Stanlib 2014).

Asset limits

In very broad terms, the significant asset allocation limits set by Regulation 28 are:

1. Equities (local and offshore)	75%
2. Immovable property (local and offshore)	25%
(PPS Investments 2012)	

It must be emphasized that the categorization set out above is a very simplistic representation of Table 1 to Regulation 28. It is, by no means, a complete list of the asset classes and limits of Regulation 28. Only some of the more interesting categories have been elaborated upon, above, to demonstrate the degree of confidence that government has in equities and immovable property (generally). A complete table of the asset classes and limits is enclosed, below, as 'annexure 1'.

Qualifications to the rule

Investors in **retirement annuity funds, pension preservation funds** and **provident preservation funds** (because retirement fund members are, really, 'investors', not so?) who had contributed to a fund member policy or established a portfolio on a retirement fund platform prior to 1 April 2011 are not required to ensure that money so-invested adhere to the limits. This is known as the 'grandfathering' clause. This is qualified by the rider that adherence is necessary if there are **material** or **significant** changes to your contract or a change to the underlying assets post-1 April 2011. Therefore, should you execute such significant transaction in the future, compliance with Regulation 28 is compulsory (PPS Investments 2012).

- Transactions nullifying the 'grandfathering' clause are those that result in a **material** change to the investment contract and include, but are not necessarily limited to:
    - Increasing or decreasing the member's existing debit order amount (Regulation 28(3) (c) (i)).
    - Changing the debit order frequency from, for example, annual debit order deductions to a monthly debit order deductions (Regulation 28(3) (c) (i)).
    - Ad-hoc/additional contributions (Regulation 28(3) (c) (i)).
    - Switching of any of the underlying funds that the member had invested in, such as switching from property to equities which might result in the limit which applies to *that* asset class (equities) being exceeded (Regulation 28(3)(c)(ii)).
- Transactions not considered to be material are :
    - Automatic annual debit order increases, which would, mostly, have been agreed upon at inception of the retirement fund plan/policy/investment. Annual increases which are agreed to after 1 April 2011 are also excluded.
    - Cancellation of a debit order by the member.
    - Re-investment of investment returns by the member.
    - An existing arrangement whereby the member is phasing an investment into his/her portfolio over a period of time.
    - A withdrawal from your preservation fund, as permitted by legislation and the fund rules. (Stanlib 2014).

Investments with inception dates after 1 April 2011:

All investments with inception dates after 1 April 2011 are required to comply with the Regulation 28 limits. The following would have occurred already:

- Asset or fund managers who manage funds for retirement funds who have a basis in unit trusts would already have ensured that those funds are Regulation 28 compliant.
- It would not be possible to compile a portfolio within a retirement fund which consists of of underlying unit trust investments that, individually and collectively, exceed the limits of Regulation 28, because the boards of trustees of all funds would have ensured that this is not possible. Even if the fund as a whole complies but the unit trusts which comprise your retirement fund portfolio do not comply, the trustees are responsible for ensuring compliance and continuing adherence to the regulation (Swanepoel 2013:170).

Conclusion: Be wary

The duty remains on trustees of retirement funds to ensure that the fund as a whole as well as the investment portfolios of individual members stay within the bounds of Regulation 28. This is a continuous process as the duty to adhere to the limits is a perpetual one (Swanepoel 2013: 169-170). At the very least, retirement fund members should be checking the benefit statements which their funds send to them on a regular basis and raise queries with the board of trustees should adherence to the regulation not be apparent.

Boards of trustees will, by now, be all too aware of the terms contained in the regulation. Because it could be easy to get lost in the many rules and obligations that trustees must adhere to, in the writer's opinion, it seems that boards of trustees should heed the intricate terms of those clauses in the regulation that could so easily be overstepped if not guarded against. Here, clauses 3(d) and 4(a) of the regulation (see 'annexure 2', below), which demand that trustees watch investment performance and the allocation of asset classes closely, come to mind.

Ultimately, the general preservation of retirement savings will be promoted by these measures to the advancement of South African society and the well-being of its citizens.

Sources of information

1. Gordhan, P., (South African Minister of Finance) Budget Speech, 2013. [Online] Available from http://www.treasury.gov.za/documents/national%20budget/2013/ [Accessed July 2013]
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3. South Africa. Pension Funds Act 24 of 1956: South African Government. Regulation 28 (2011) Pretoria: Government Printing Works.
4. PPS Investments (2012) Regulation 28: What it means for you.[Online] Available from http://www.ppsinvestments.co.za/assets/reg28/Regulation_28_ [Accessed: 22 January 2014]
5. STANLIB (2014) Regulation 28 explained.[Online] Available from http://www.stanlib.com/Regulation28 [Accessed: 24 January 2014]
6. Swanepoel, A., 2013, The Pension Funds Act, 1956in Hanekom, K (ed), 2013, Manual on South African Retirement Funds and other Employee Benefits. Durban: LexisNexis.

Annexure 1

Table 1

Item	Column 1 Categories of Assets	Column 2 Limits being the maximum percentage of aggregate fair value of total assets of fund Per issuer/entity, applicable	 For all issuers/as entities
	CASH		**100%**
1.	1.1 Notes and coins; any balance or deposit in an account held with a South African bank; A money market instrument issued by a South African bank including an Islamic liquidity management financial instrument; Any positive net balance in a margin account with an exchange; and Any positive net balance in a settlement account with an exchange, operated for the buying and selling of assets.	25%	100%
	1.2 Any balance or deposit held with a foreign bank; A money market instrument issued by a foreign bank including an Islamic liquidity management financial instrument;	5%	
	DEBT INSTRUMENTS INCLUDING ISLAMIC DEBT INSTRUMENTS		**100% for debt instruments issued by or guaranteed by the Republic, otherwise 75%**
	2.1 Inside the Republic and foreign assets		
	a) Debt instruments issued by, and loans to, the government of the Republic, and any debt or loan guaranteed by the Republic		100%
	b) Debt instruments issued or guaranteed by the government of a foreign country	10%	
	Debt instruments issued or guaranteed by a South African bank against its balance sheet: -		75%

2.		i)	listed on an exchange with an issuer market capitalisation of R20 billion or more, or an amount or conditions as prescribed	25%	
	c)	ii)	listed on an exchange with an issuer market capitalisation of between R2 billion and R20 billion, or an amount or conditions as prescribed	15%	
		iii)	listed on an exchange with an issuer market capitalisation of less than R2 billion, or an amount or conditions as prescribed	10%	
		iv)	not listed on exchange	5%	25%
	d)		Debt instruments issued or guaranteed by an entity that has equity listed on an exchange, or debt instruments issued or guaranteed by a public entity under the Public Finance Management Act, 1999 (Act No. 1 of 1999) as prescribed: -	10%	50%
		i)	listed on an exchange	10%	50%
		ii)	not listed on exchange	5%	25%
	e)		Other debt instruments: -	5%	25%
		i)	listed on an exchange	5%	25%
		ii)	not listed on exchange	5%	15%
	EQUITIES				**75%**
	3.1		Inside the Republic and foreign assets		
			Preference and ordinary shares in companies, excluding shares in property companies, listed on an exchange: -		75%
3.	a)	i)	issuer market capitalisation of R20 billion or more, or an amount or conditions as prescribed	15%	
		ii)	issuer market capitalisation of between R2 billion and R20 billion, or an amount or conditions as prescribed	10%	
		iii)	issuer market capitalisation of less than R2 billion, or an amount or conditions as prescribed	5%	
	b)		Preference and ordinary shares in companies, excluding shares in property companies, not listed on an exchange	2.5%	10.0%
	IMMOVABLE PROPERTY				**25%**
	4.1		Inside the Republic and foreign assets		
			Preference shares, ordinary shares and linked units comprising shares linked to debentures in property		25%

4.		companies, or units in a Collective Investment Scheme in Property, listed on an exchange:-			
	a)	i) issuer market capitalisation of R10 billion or more, or an amount or conditions as prescribed	15%		
		ii) issuer market capitalisation of between R3 billion and R10 billion, or an amount or conditions as prescribed	10%		
		iii) issuer market capitalisation of less than R3 billion, or an amount or conditions as prescribed	5%		
	b)	Immovable property, preference and ordinary shares in property companies, and linked units comprising shares linked to debentures in property companies, not listed on an exchange	5%		15%
		COMMODITIES		10%	
	5.1	Inside the Republic and foreign assets			
5.	a)	Kruger Rands and other commodities listed on an exchange, including exchange traded commodities: -			10%
		i) gold	10%		
		ii) each other commodity	5%		
		INVESTMENTS IN THE BUSINESS OF A PARTICIPATING EMPLOYER INSIDE THE REPUBLIC IN TERMS OF: -			
6.	a)	section 19(4) of the Pension Funds Act			5%
	b)	To the extent it has been allowed by an exemption in terms of section 19(4A) of the Pension Funds Act			10%
7.		HOUSING LOANS GRANTED TO MEMBERS IN ACCORDANCE WITH THE PROVISIONS OF SECTION 19(5)			95%
		HEDGE FUNDS, PRIVATE EQUITY FUNDS AND ANY OTHER ASSET NOT REFERRED TO IN THIS SCHEDULE			**15%**
	8.1	Inside the Republic and foreign assets			
		Hedge Funds			10%
	a)	i) Funds of hedge funds	5% per fund of hedge funds		
8.		ii) Hedge funds	2.5% per hedge fund		

	Private equity funds		10%
b)	i) Funds of private equity funds	5% per fund of private equity funds	
	ii) Private equity funds	2.5% per private equity fund	
c)	Other assets not referred to in this schedule and excluding a hedge fund or private equity fund		2.5%

Effective date

3. This regulation comes into effect on 1 July 2011, provided that transitional arrangements may be prescribed.

Annexure 2

Excerpt from Regulation 28 of the Pension Funds Act 24 of 1956

Regulation 28 (3)(d)A A fund must not invest or contractually commit to invest in an asset, including a hedge fund or private equity fund, where the fund may suffer a loss in excess of its investment or contractual commitment in the asset. This does not preclude a fund from investing in derivative instruments subject to sub regulation (7). Hedge funds and private equity funds that may expose the fund to a liability must be held in a limited liability structure.

Regulation 28 (4)(a) A fund must not utilize any asset to circumvent the limits as set out in this regulation and, where an asset is made up of underlying assets, the fund must include and disclose the underlying assets in the category in Table 1 to which the economic exposure of the underlying assets relate.