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Update to act 'fails to address flaws'

In February changes to Regulation 28 of the Pension Funds Act were announced that seek to set prudent overall risk limits for retirement fund investments in relation to particular assets or asset classes. According to National Treasury, rather than "ban" high risk classes of assets, Regulation 28 aims to mitigate risks "through the proper valuation and diversification of investments, with transparency to the supervisor, disclosure to the member, and a tighter overall limit".

While the move has been largely welcomed by local asset managers, particularly the upward revision of the offshore investment limits for pension funds, concerns have been raised regarding the limits, or lack thereof, that pertain to various debt instruments.

"Arguably, Regulation 28 is the most important piece of legislation governing financial investments in SA, and it affects every member of any public or private retirement fund," says Andrew Canter, Futuregrowth Asset Management chief investment officer. "However, with regard to debt instruments, we find Regulation 28 is out of step with its goal of prudence."

Canter says the recent amendments failed to deal with fundamental flaws in the areas of bond and money-market investments. More worryingly, Regulation 28's exposure limits to banks are too high.

"Despite the poor track record of banks in SA — by our count various banks have failed or come close to failure every 15 months on average over the past 25 years — Regulation 28 permits a pension fund to have up to 100% of its total assets invested in banks."

Canter's view is that by allowing for potential overexposure to banks, the limits imposed by Regulation 28 are neither suitable nor prudent, particularly as the regulation makes no distinction between banks' senior-debt and subordinated-debt instruments. "Clearly, not all debt instruments are equal, but because Regulation 28 does not make any distinction, a pension fund could have a substantial part of its assets exposed to subordinated-debt instruments, which can suffer losses of up to 100% in a bank failure."

Canter suggests Regulation 28 should be further revised such that the overall exposure limits to the banking sector be reduced; the exposure limit to individual banks be materially reduced; and there should be a distinction in exposure limits between a bank's senior and subordinated instruments.

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