GRADIDGE MAHURA INVESTMENTS

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Hands off my Pension

In recent commentary the ANC's head of Economic Transformation, Enoch Godongwana has made it clear that the party is moving away from the term "prescribed assets" as economic policy and to rather focus the conversation (and potential policy changes) on finding ways to unlock South Africa's pensions to assist with the country's infrastructure goals. The issue of prescribed assets started gaining traction after the ANC's 2019 election manifesto, which tabled the introduction of prescribed assets on financial institution funds for social productive investments including; housing, infrastructure for social and economic development and the development of townships and the village economy.

The current debate has now shifted to whether pension fund assets can be used more effectively to support economic growth and provide much needed funding for economic development, without prescription i.e. "should Regulation 28 of the Pension Funds Act have a minimum allocation to infrastructure" to "does Regulation 28 allow sufficient flexibility to invest in infrastructure"?.

As Regulation 28 remains central to the debate it is important to gain a better understanding of the; influence, objectives, and current parameters of Regulation 28. Regulation 28 applies to; pension funds, provident funds, retirement annuities and preservation funds. Thus, the impact and reach are significantly broader than the "pension fund" industry and in some way impacts most savers and investors.

Regulation 28 provides guidance of where pension fund managers, investors, and asset managers should invest their retirement savings. Most retirement savings are invested in balanced funds where the; pension fund and asset manager has to ensure adherence to regulation 28.

The primary objective of Regulation 28 is to manage investment risk and ensure investors do not take undue risk with their retirement savings. This is achieved through providing investment maximums to manage investment risk. Some of these broad parameters include a maximum of 75% invested in shares; a maximum of 25% in property and a maximum 30% invested in international assets (excluding Africa). Each one of these broader categories are then broken down further limiting the exposure to i.e. any share or exposure per debt instrument.

Regulation 28 currently allows investment into infrastructure; these investments are most often structured as private equity funds and as such between 10% and 2,5% can be invested in infrastructure related investments (this does depend on the underlying legal structure). Currently South African pension funds invest +/- 1 % into unlisted infrastructure. At face value South African pension funds and asset managers are significantly under invested in infrastructure. However, a 2019 survey by the OECD provides some more insight into the allocation of large global pension funds to infrastructure. Even though the allocation to alternatives has continued to grow globally (now at 14,4%) there has only been a marginal increase to unlisted infrastructure during recent years, from 1,8% to 2% in the most recent survey.

The reason for this lower allocation can certainly not be attributed to performance. A number of South African- and global Asset managers have established infrastructure funds, investing into a range of opportunities including renewable energy, housing, village "developments", education, roads rail and ports and also venture into areas such as agriculture. Some of these have now established exceptional track records over the last 10 years.

In order to invest more in the "real" economy and directly into infrastructure projects, the challenge is not the current limits of Regulation 28 or the availability of opportunities but rather the structure of the pension funds and also the structure of the underlying alternative (infrastructure) investment opportunities.

The following are some of the structural challenges in allocating more pension fund assets to infrastructure:

- Pension funds require liquidity
- Pension funds require liquidity to provide regular member pay-outs and claims. Private equity and infrastructure related investments traditionally have a very long-term time frame 7 to 10 years with limited liquidity during the period.
- The SA market is still relatively concentrated
- Even though some asset managers have ventured into this market, the investable universe is still relatively small limiting the available opportunities. This increases risk and makes it difficult to implement a diversified strategy.
- The retail market can't access infrastructure opportunities The retail market can only access debt (or bonds) associated with infrastructure projects as they require daily liquidity.

In order to allocate more pension fund capital to infrastructure, the real issue is not the regulation, but rather finding innovative structural solutions and investment opportunities to allow pension money to flow into infrastructure investments.

Pension fund managers, Principle Officers and Trustees of pension funds (including Pension Funds, Provident Funds, Retirement Annuities and preservation funds) have a fiduciary responsibility to manage pension assets on behalf of members and to appropriately manage the risk within the fund. In a constitutional democracy It seems inconceivable that these fiduciary obligations will be infringed upon. I suspect we will see more PPP collaboration and the development and deepening of the industry to broaden the infrastructure opportunity set available to pension investors.

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