Revised Regulation 28 and its impact on your fund and members

22 June 2011

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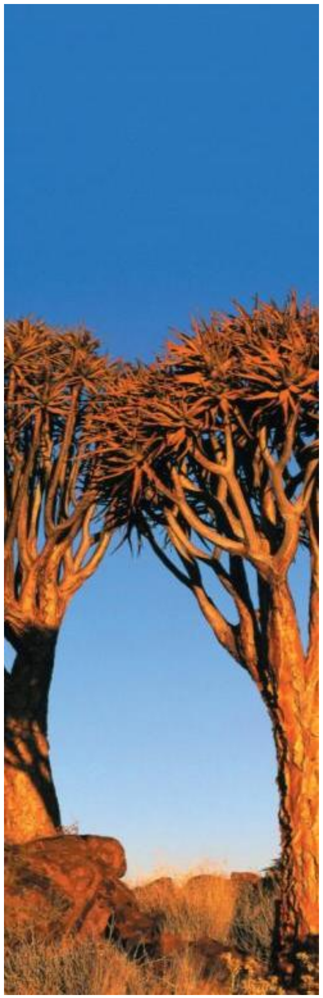
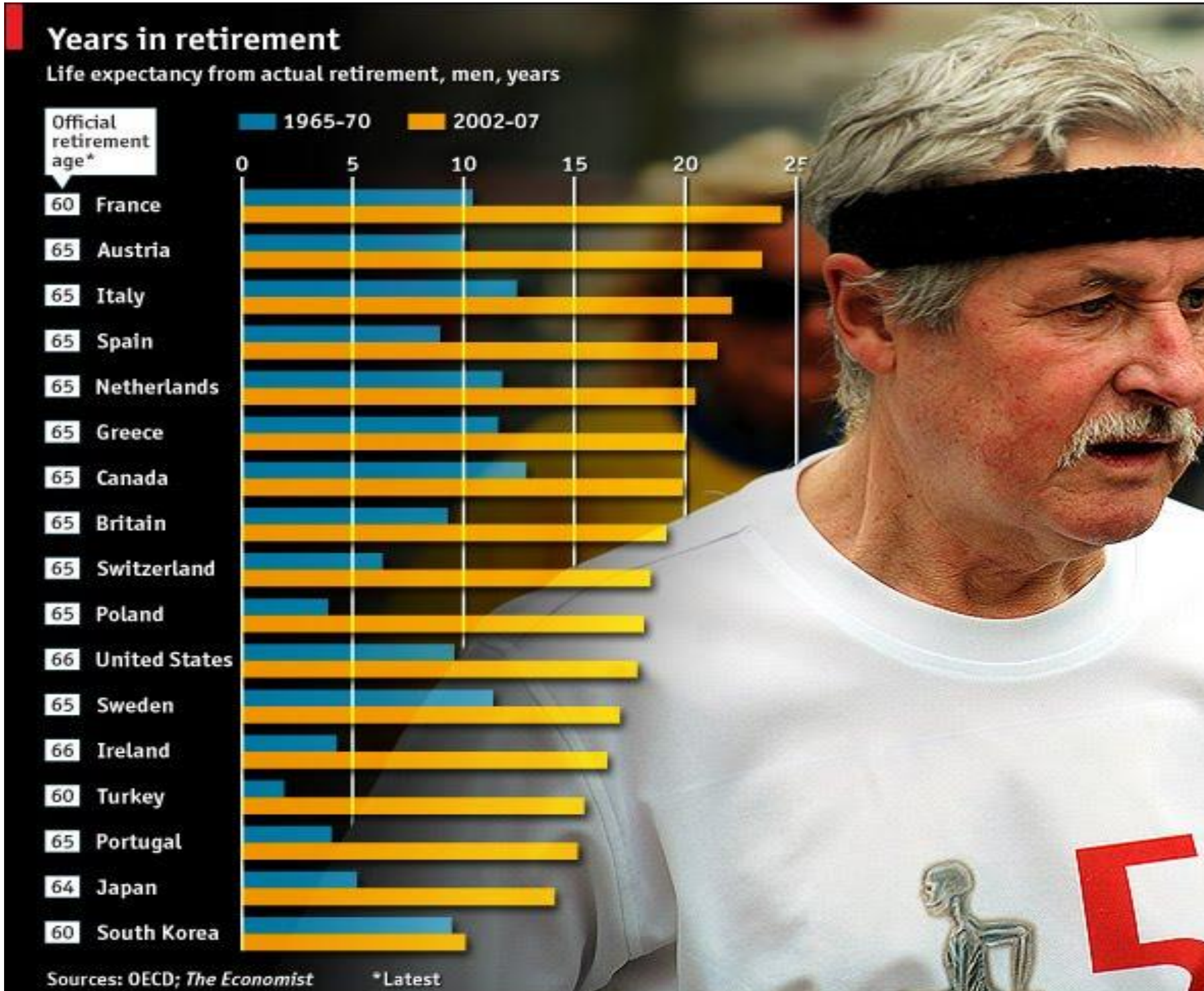
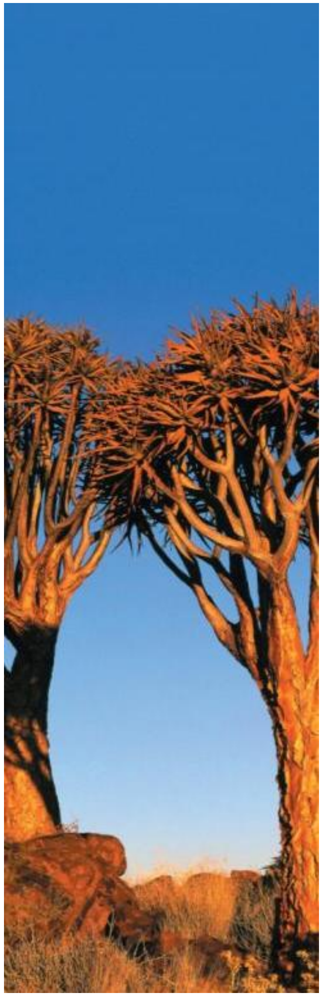
living longer





the impact of living longer

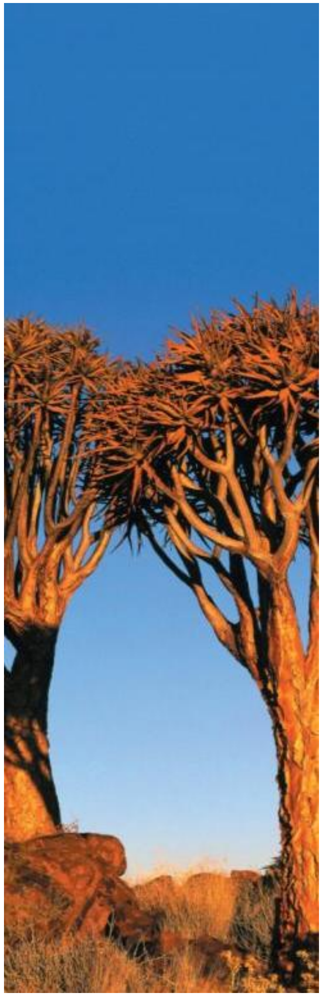


~ male retiring at age 65

~ requires monthly pension of R10,000 increasing in line with inflation

expected age at death	lump sum required at age 65	increase over current
80	1,340,522	
81	1,407,270	5%
82	1,474,519	10%
83	1,542,089	15%
84	1,609,769	20%
85	1,677,313	25%

and the implications for retirement



members need to:

~contribute more

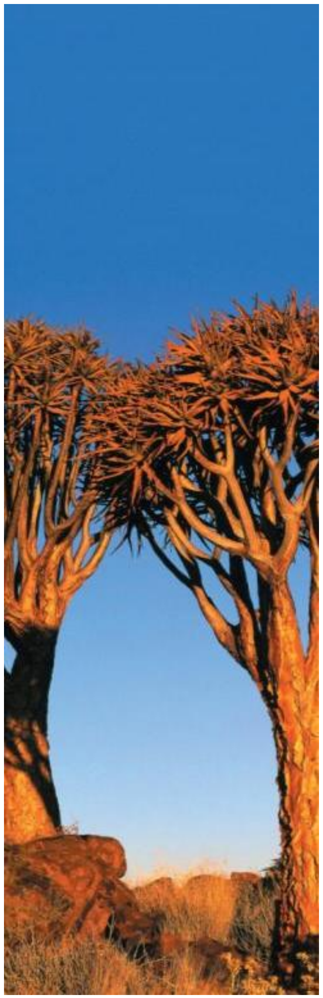
~preserve diligently

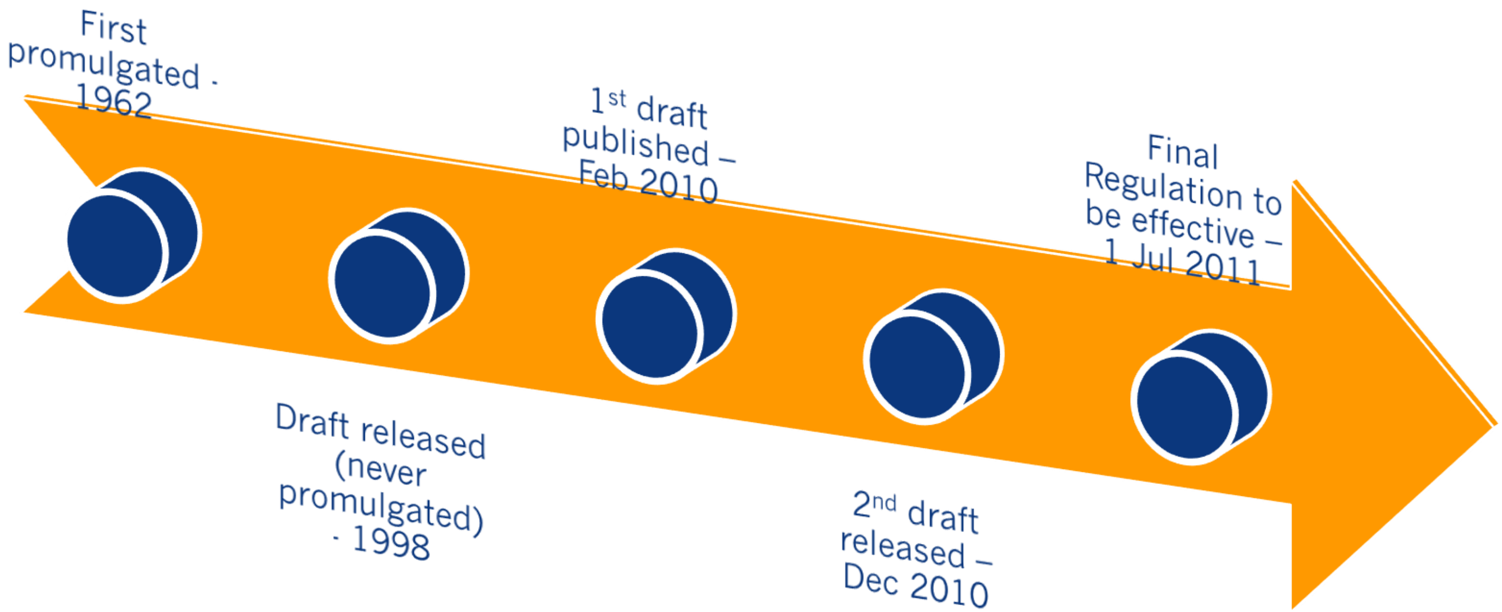
~retire later

AND

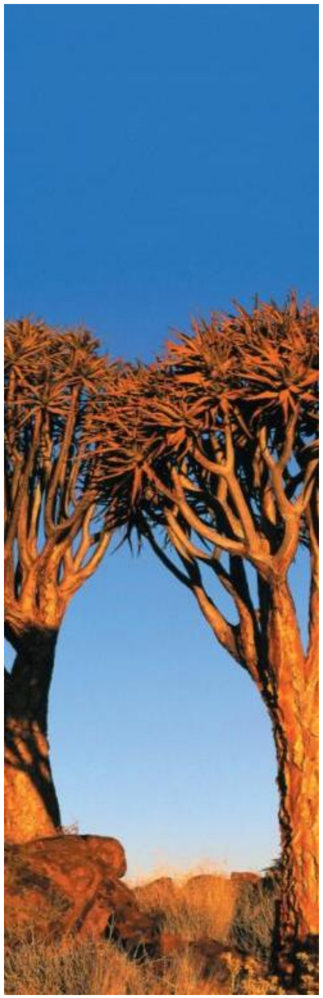
~invest more wisely

brief timeline of Regulation 28



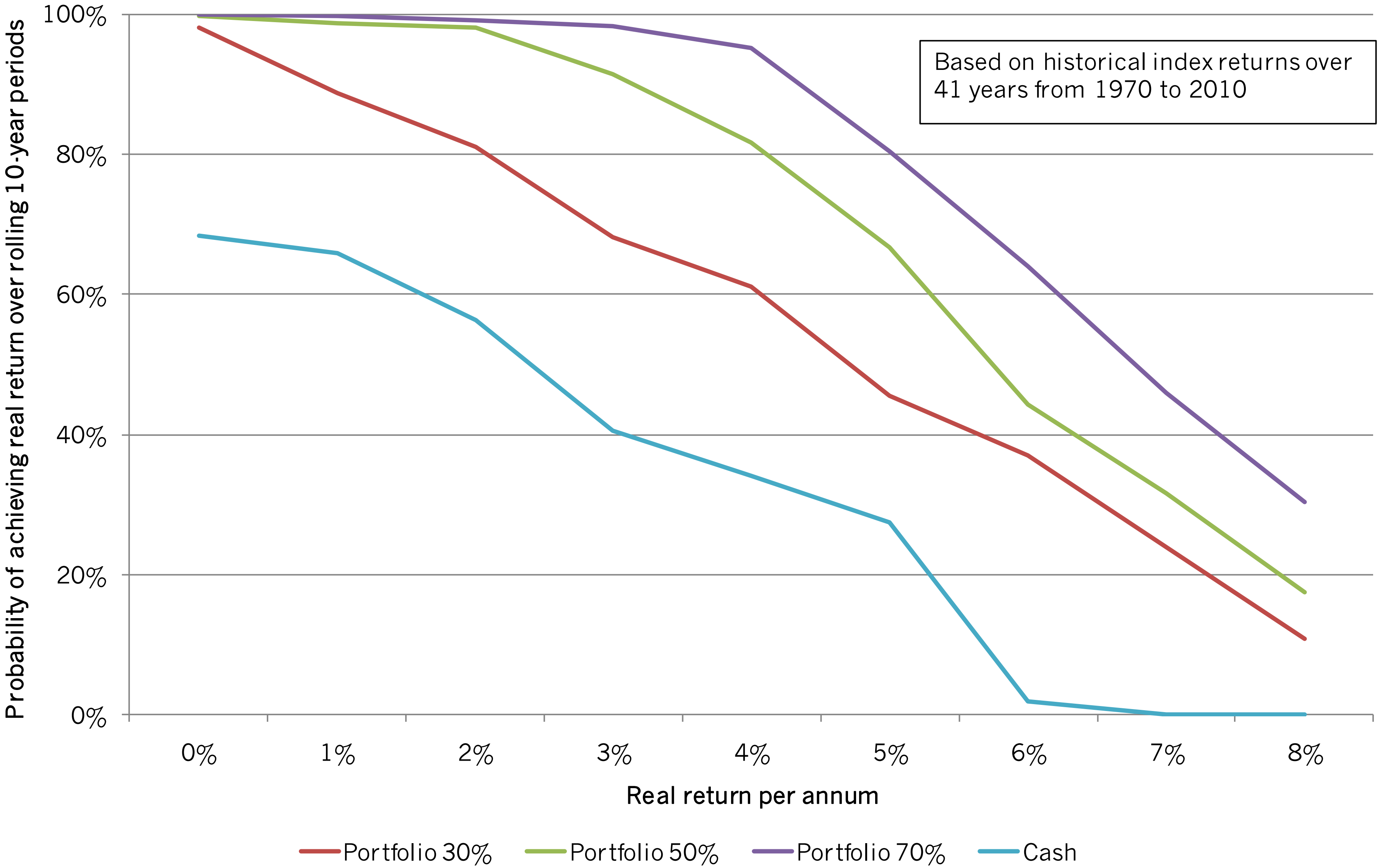


current Regulation 28

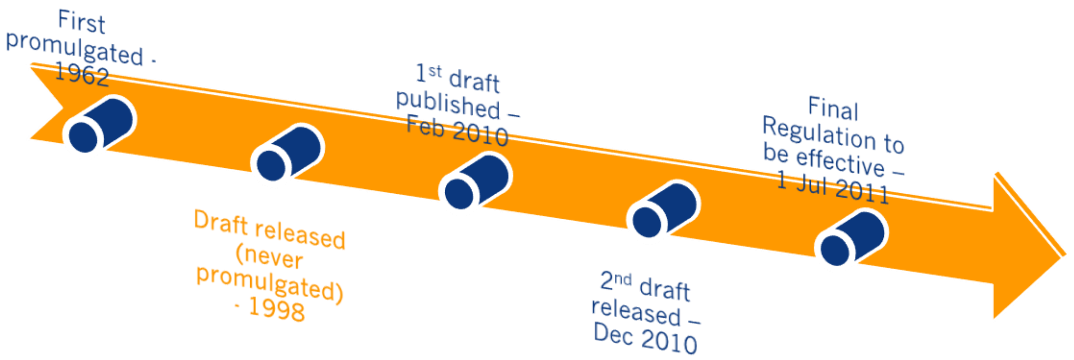


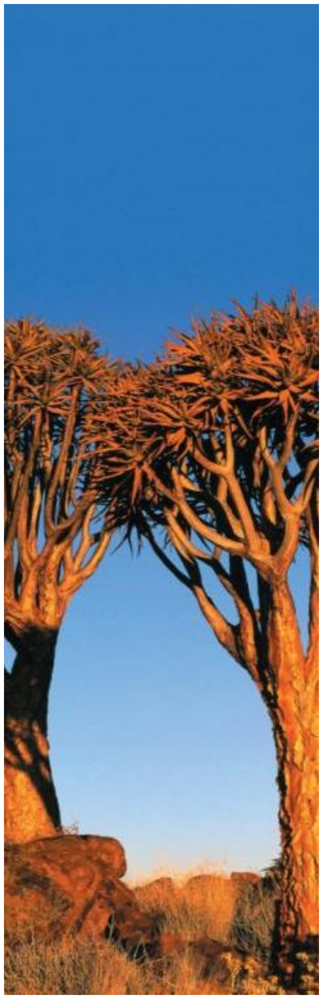
- <u>positives</u>
  - easy to comply with
  - prevents excessive risk taking
  - reduces concentration risk (except fixed income)
  - individual member flexibility if fund as a whole complies ... also a negative
- <u>negatives</u>
  - encourages herd mentality
  - does not provide enough guidance
  - absence of limits on SA fixed income assets may encourage reckless conservatism
  - not suitable for defined contribution and member choice
  - outdated

reckless conservatism



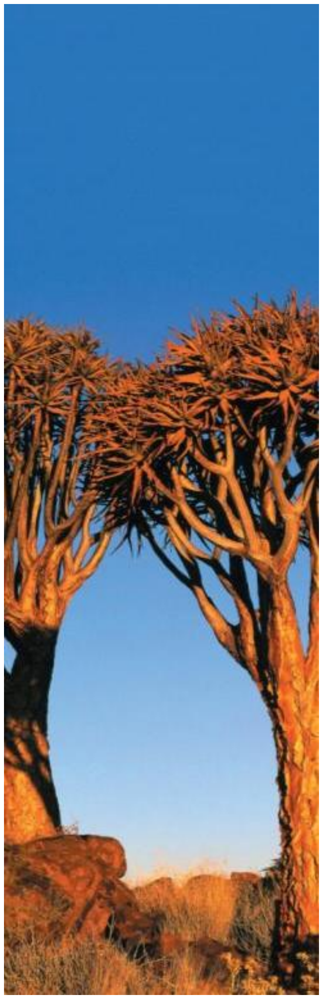
the changes: previous draft (1998)





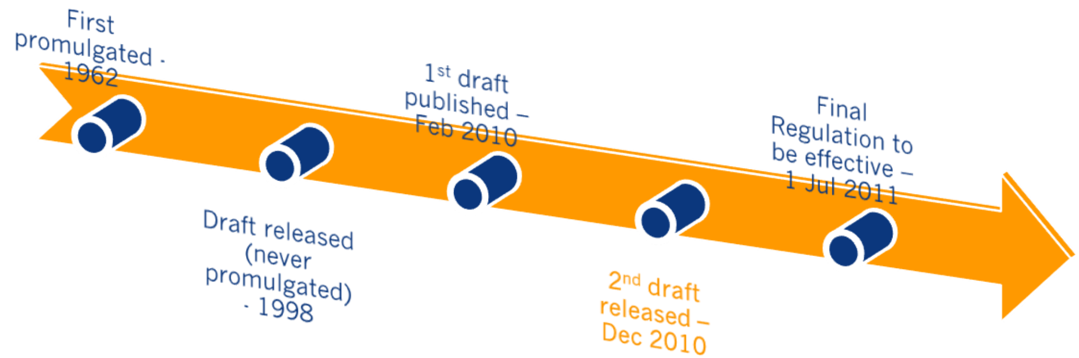
- ~ principles based – no asset class limits
- ~ aim was to discourage herd mentality
- ~ acknowledged unique profile of each fund, encouraged trustees to develop a strategy specific to their fund's profile
- ~ never promulgated but widely accepted and adopted by the industry

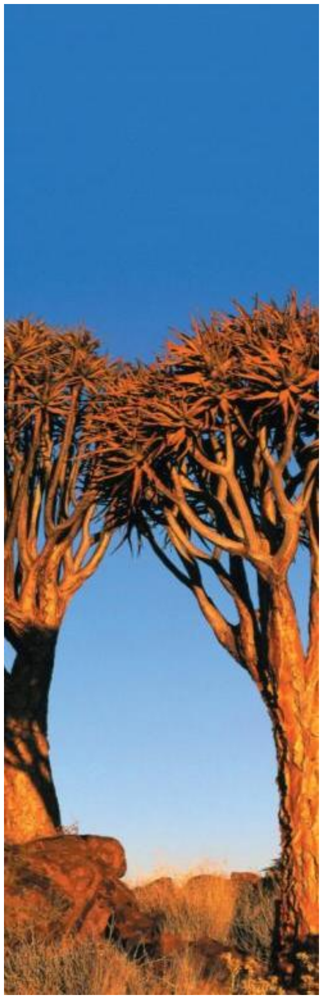
the changes: 1st draft (2010)



- ~ abandoned principles-based approach, returned to asset class limits
- ~ offshore limits brought in line with exchange control regulations
- ~ application of look-through principle
- ~ asset class limits applicable at member level

the changes: 2nd draft (2010)





~ combined asset class limits with principles that emphasise a process based approach

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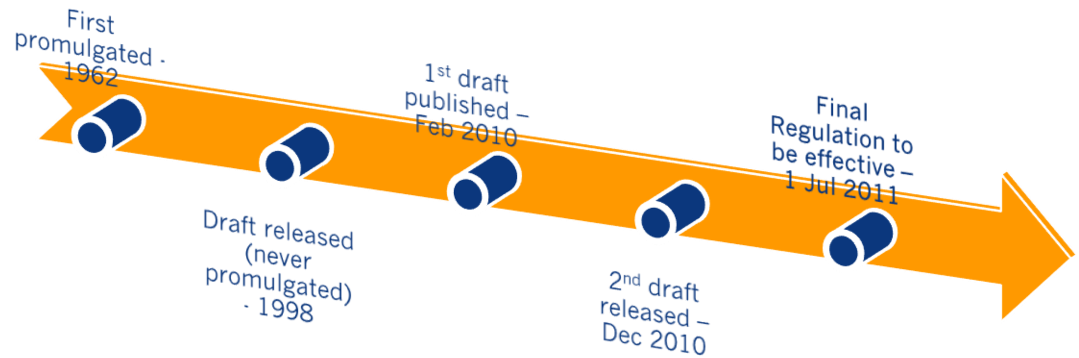
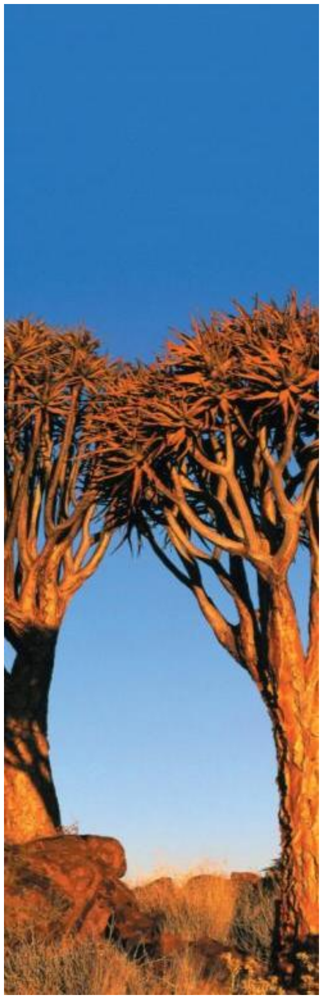
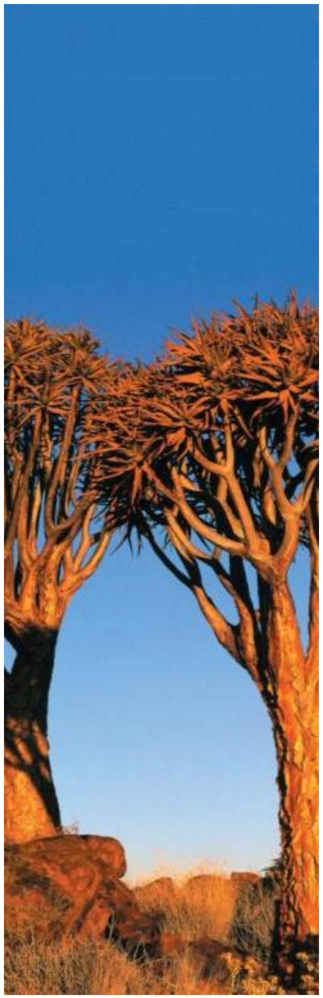
the changes: final (2011)





- ~ retained most of 2nd draft
- ~ some exclusions from 2nd draft e.g. direct housing loan limit
- ~ mostly minor amendments
- ~ more work required on guidance notes

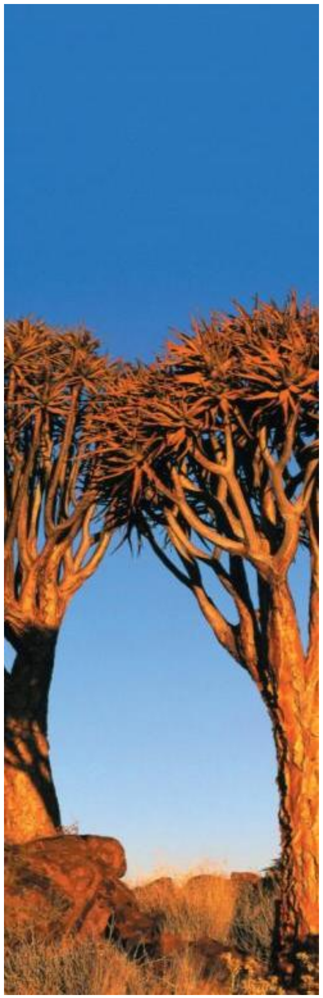
the limits



	Old	New
Equities - large - medium - small	75% 15% N/A 10%	75% 15%*** 10%*** 5%***
Property - listed - unlisted	25% N/A N/A	25% 25% 15%
Equities and property	90%	N/A
Sponsoring employer	5%*	5%*
Cash per bank	20%	25%
Bank debt - single bank	100% 20%	75% up to 25%**
Offshore - Africa	15%	25% add 5%

*10% if exemption obtained
** 30% for Collective Investment Schemes
*** checked for inflation pressure

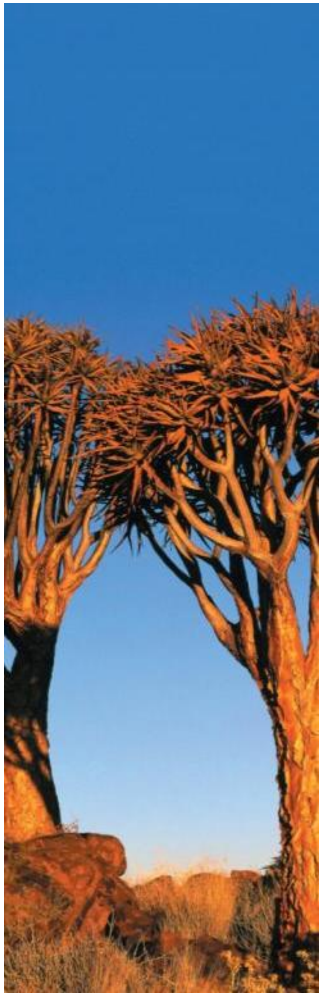
the limits



	Old	New
Other - excluding hedge and private equity	2.5%	15%* 2.5%
Commodities - gold - other	5% Kruger Rands only	10% 10% 5%
Hedge funds	N/A**	10%
Private equity	N/A	10%
Hedge funds & private equity	N/A	15%
Unlisted equity (including private equity)	7.5%	15%***
Unlisted and alternative assets	N/A	35%

*includes hedge funds & private equity
**use of debentures to circumvent
*** diversification 2.5% per entity

key changes to revised Regulation



- introduction of principles to guide and inform investment decision making at each stage of the investment process
  - IPS

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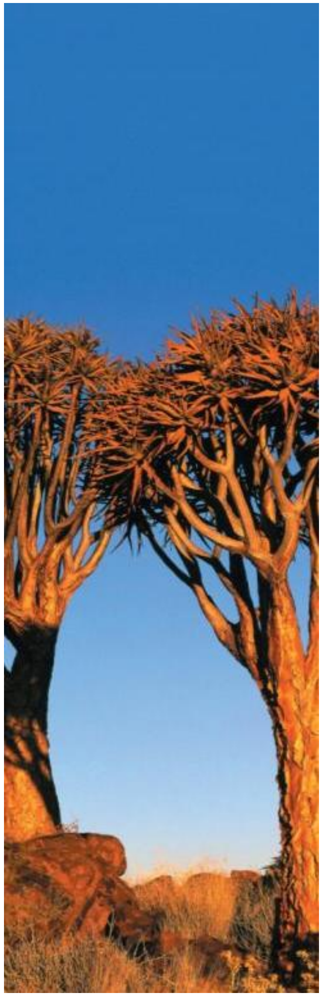
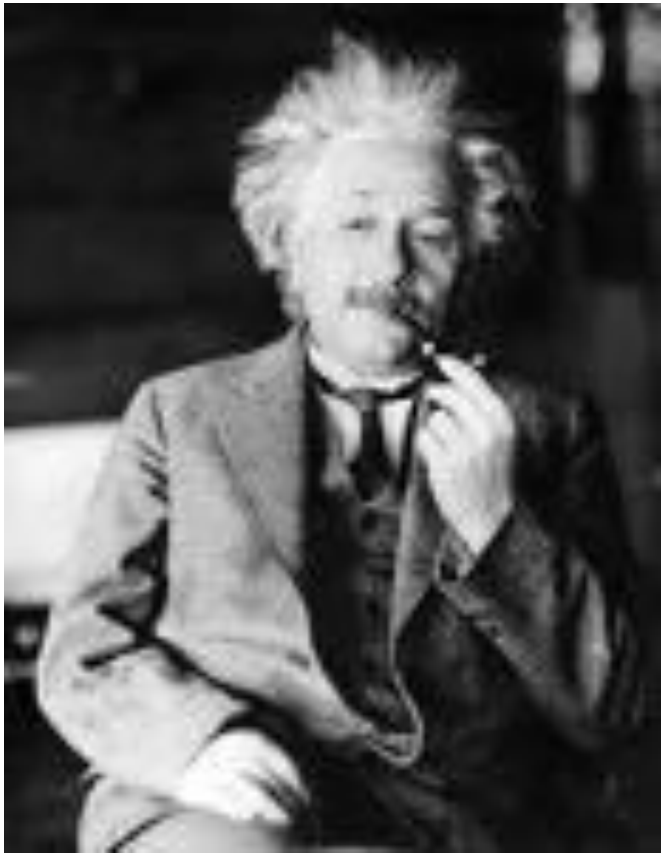
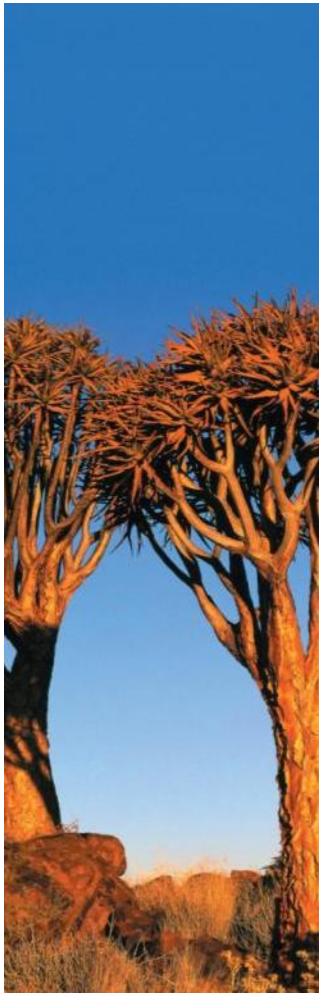


"Things should be as simple as possible, but not simpler."

Albert Einstein

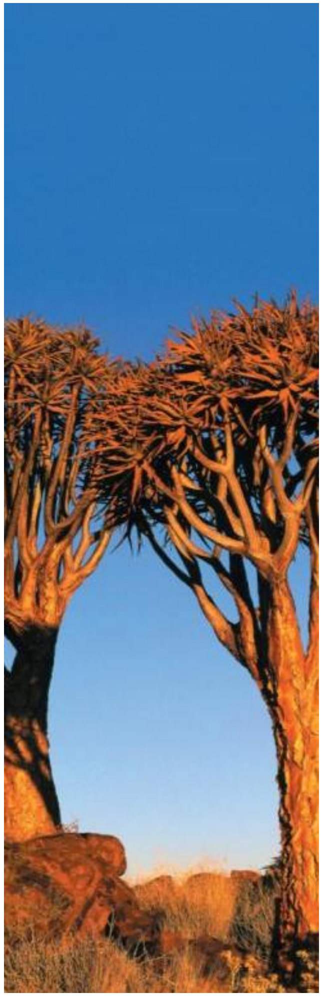


develop a framework



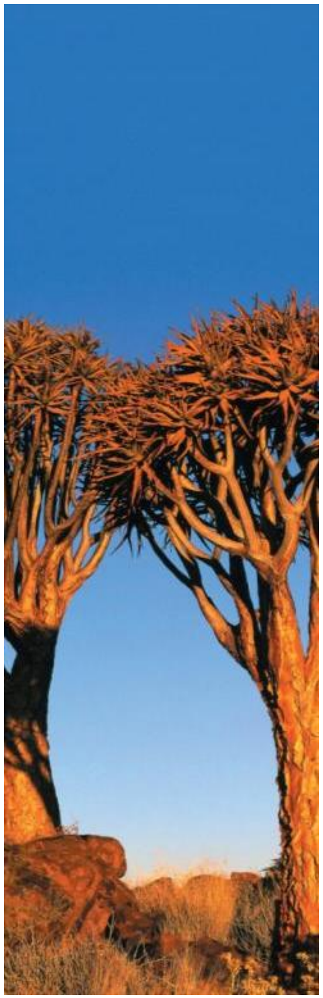
~ spend time developing your investment framework
~ identify key decisions ... focus time, cost and effort on these
~ keep it simple
~ make sure it's *your* framework
~ document it
~ stick to it
~ revisit it from time to time

developing an investment strategy



Investment Policy Statement (IPS)

investment policy statement



(2) (b) A fund must have an investment policy statement, which must be reviewed at least annually

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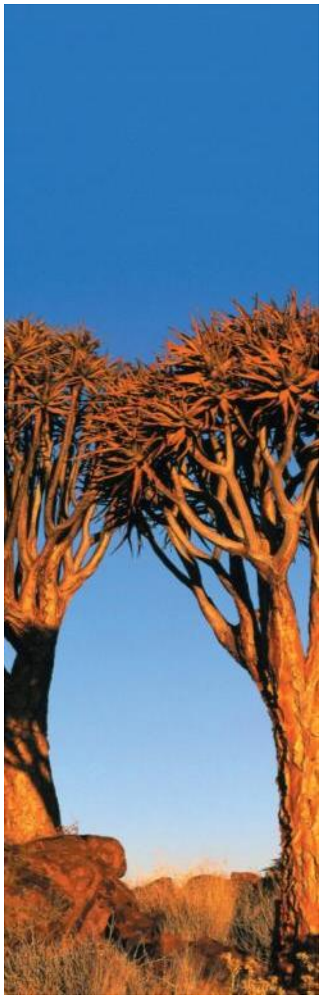
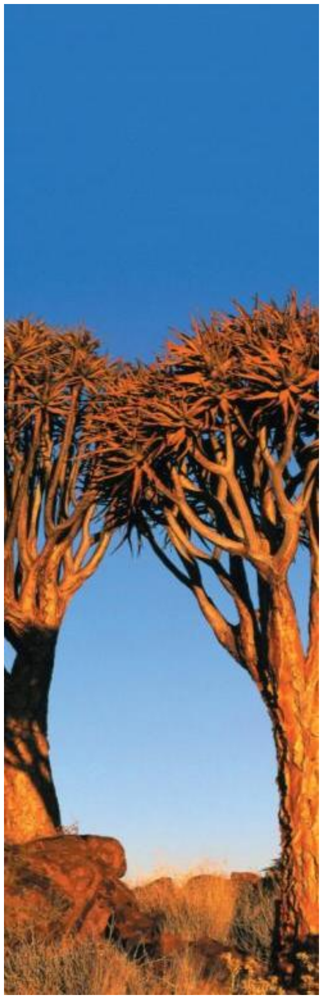
why do you need an IPS?



- ~ protects the fund, trustees and members
- ~ sets a sound framework for decision making
- ~ reference point for decision making
- ~ avoid unnecessary reinvention of the wheel
- ~ improve quality of decision making
- ~ ensures clear responsibilities for functions in investment process
- ~ shows that trustees have applied their minds
- ~ enables new trustees or service providers to understand the strategy

investment policy statement



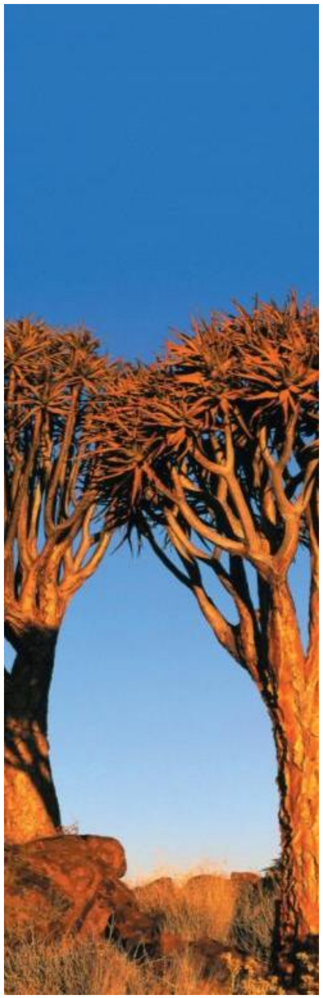
"means a document which, at least: -

a) describes a fund's general investment philosophy and objectives as determined by its liability profile and risk appetite;

b) addresses the principles referred to in subregulation (2)(c); and

c) complies with conditions as may be prescribed;"

investment policy statement



~ subregulation 2 (c)

i. promote education of board
ii. monitor compliance with regulation
iii. promote BEE
iv. assets appropriate for liabilities
v. due diligence taking account of credit, market, liquidity, operational risks of unlisted assets
vi. due diligence of above risks plus currency and country risks of foreign assets
vii. use of credit ratings
viii. risk analysis – changing risk profile
ix. sustainability factors i.e. ESG

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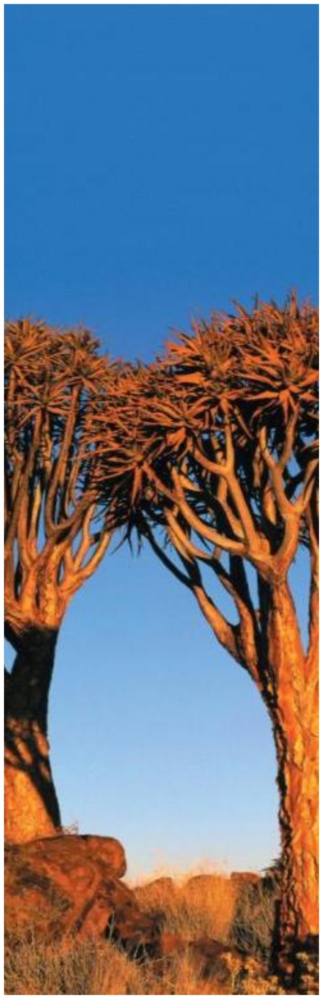
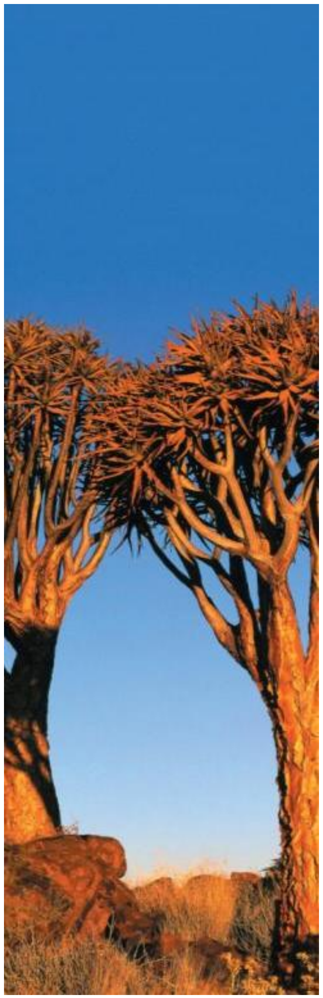
essential elements of the IPS



- philosophy and objectives
  - philosophy and framework
  - clearly defined objectives
  - categories of liabilities
  - time frame
- investment strategy
  - range of authorized investments
  - limitations on quality and proportion of assets
  - dealing with breaches
  - use of derivatives
  - dealing with cash flows
- asset managers
  - selection process and criteria
  - restrictions on mandates
  - replacement

essential elements of the IPS



- diversification
  - intelligently
  - diversify risk while optimising returns
  - beware of over-diversification and costs
- liquidity requirements
  - future cash flow needs
  - check liquidity of investments
- monitoring
  - frequency
  - nature and type of reports
  - regular reviews
- costs
  - all costs (manager, custodian and transaction)
  - fees linked to clearly defined responsibilities
  - disclosure

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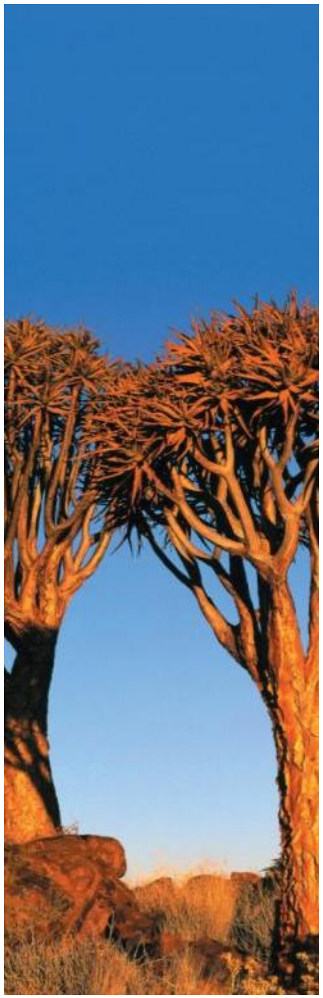
essential elements of the IPS



- risk management
  - all fund risks identified and processes to mitigate them
  - external independent party assess fund governance structures
- voting rights
  - shareholder activism
  - normally, these policies included in asset manager mandates
- responsibilities
  - who does what?
  - how are they measured?

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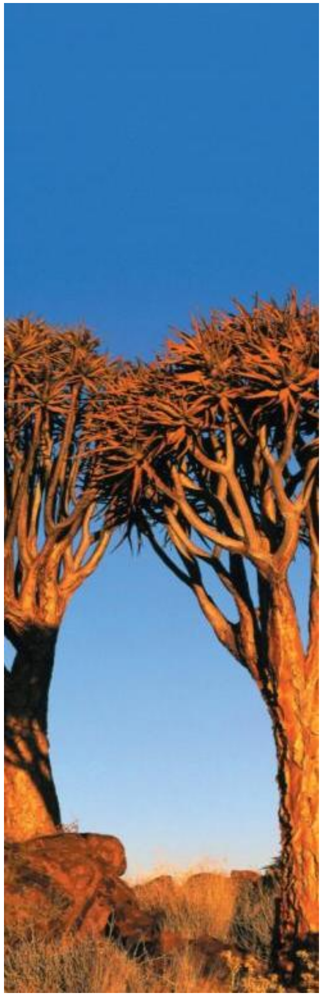
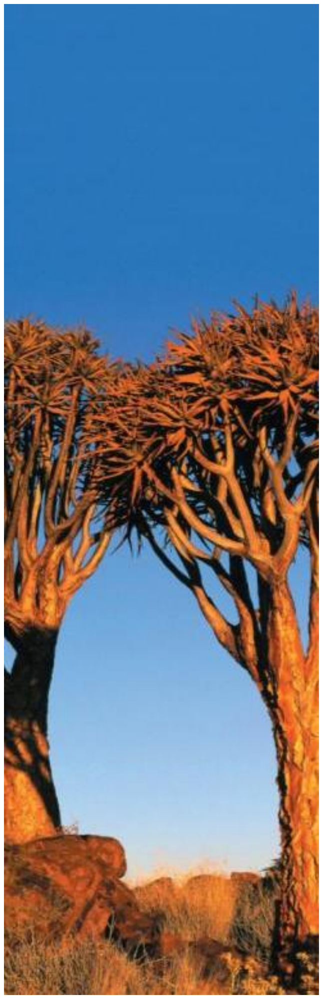
key changes to revised Regulation



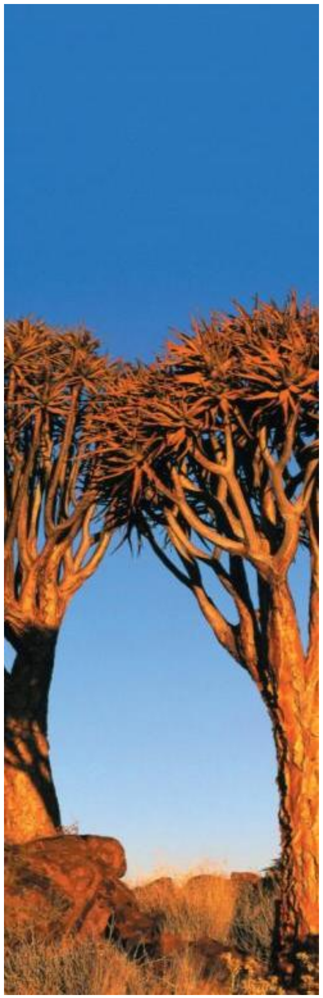
- ~ application of look-through principle
  - ~ calculation of exposure
  - ~ report on underlying assets, not just legal structures
  - ~ not in respect of hedge fund or private equity except for foreign assets
- ~ member level compliance
  - ~ member choice portfolios compliant at member level

key changes to revised Regulation



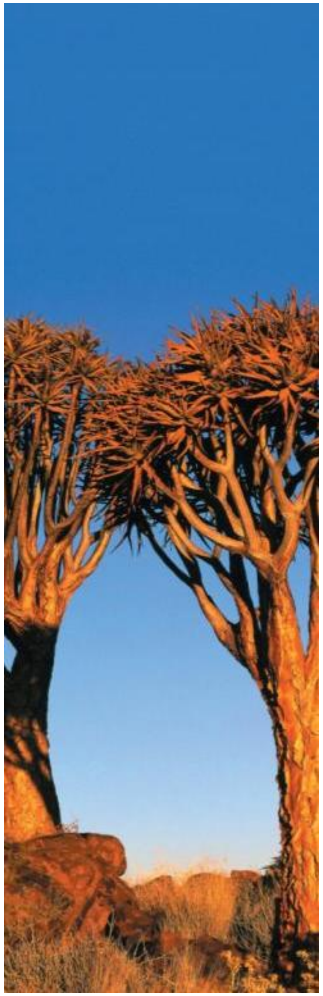
- ~ exemption of long-term insurance policies with a guarantee
  - ~ only long-term policies with ‘bona fide’ guarantee remain exempt
  - ~ guidance note expected
- ~ foreign exposure
  - ~ aligned with Exchange Control regulations
  - ~ currently 25% offshore with additional 5% in Africa

key changes to revised Regulation



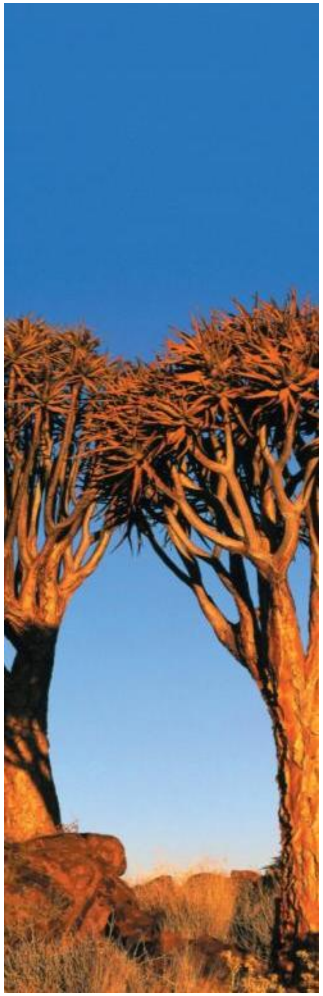
- socially responsible investing
  - not considered a separate asset class but a subset of each asset class
  - ESG principles to be defined by the fund's IPS
- Shari'ah compliant investments
  - provision now made in Regulation
- retirement annuities issued by life companies
  - need to comply

key changes to revised Regulation



- derivatives
  - provision for use of derivatives
  - not an asset class, look-through to underlying asset exposure to assess compliance
  - principle: not for gearing or leverage purposes, only for hedging and efficient portfolio management
  - guidance note expected
- securities lending
  - provision for securities lending
  - guidance note expected

key changes to revised Regulation



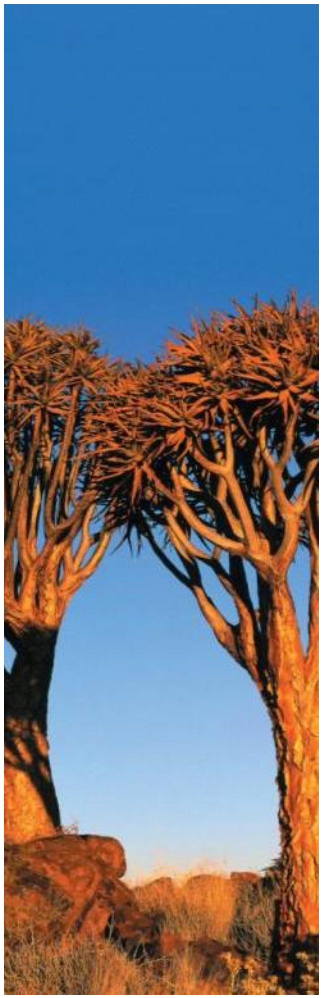
~ alternative investments

- ~ commodities
- ~ hedge funds
- ~ private equity
- ~ Africa
- ~ care is needed

~ reporting

- ~ daily compliance with limits
- ~ practical obstacles
- ~ awaiting guidance from FSB
- ~ exemption – temporary or permanent

guidance notes expected



~ use of derivatives

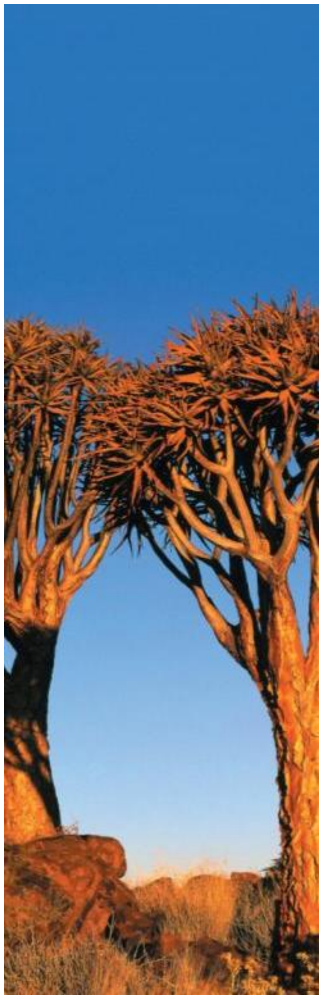
~ exemption of long-term insurance policies with guarantees

~ how individual members will be expected to comply with the revised investment limits

~ use of hedge fund investments

~ use of securities lending

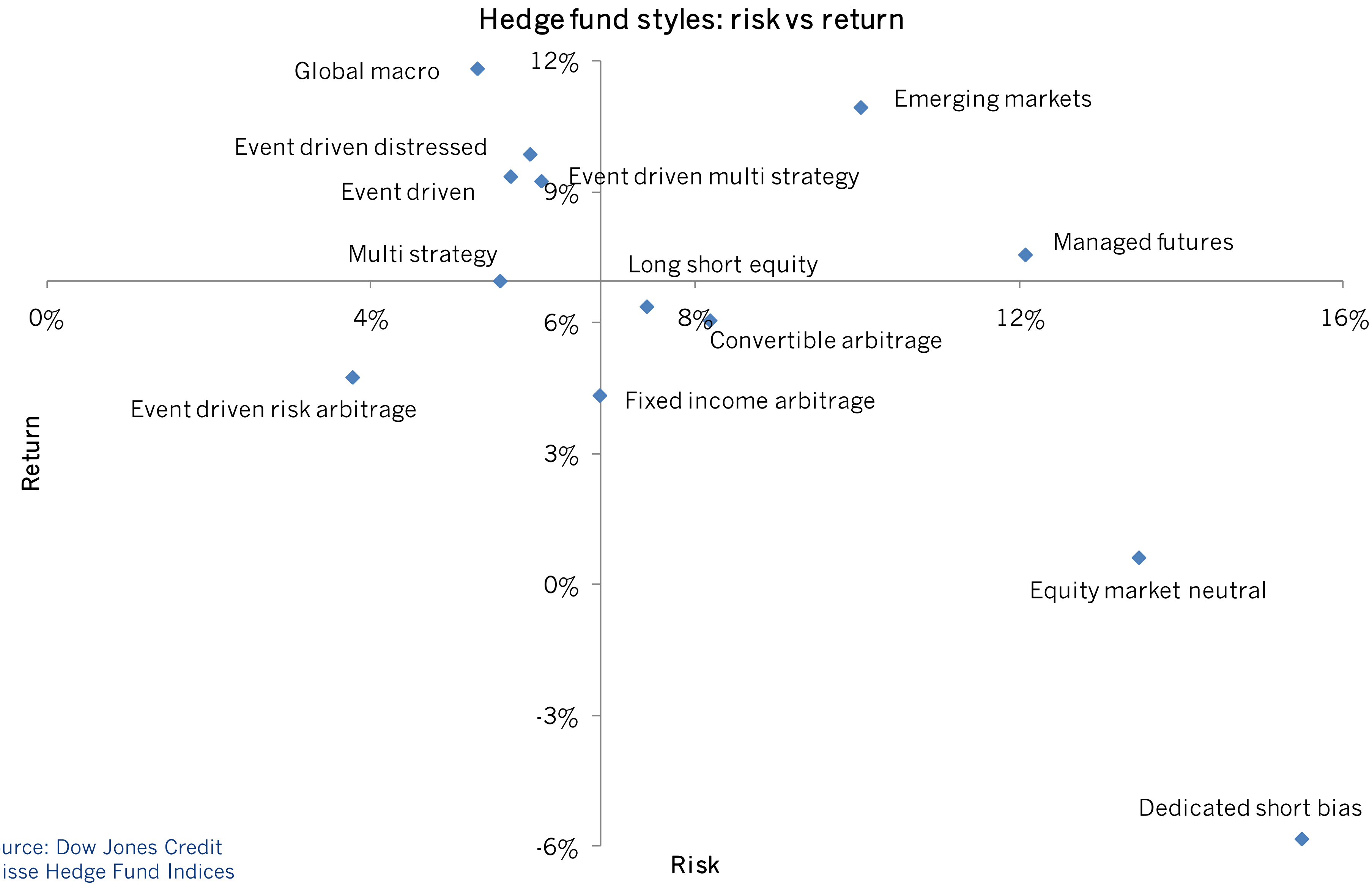
a quick look at hedge funds and private equity



A hedge fund is a private investment fund that participates in a range of assets and a variety of investment strategies intended to protect the fund's investors from downturns in the market while maximizing returns on market upswings.

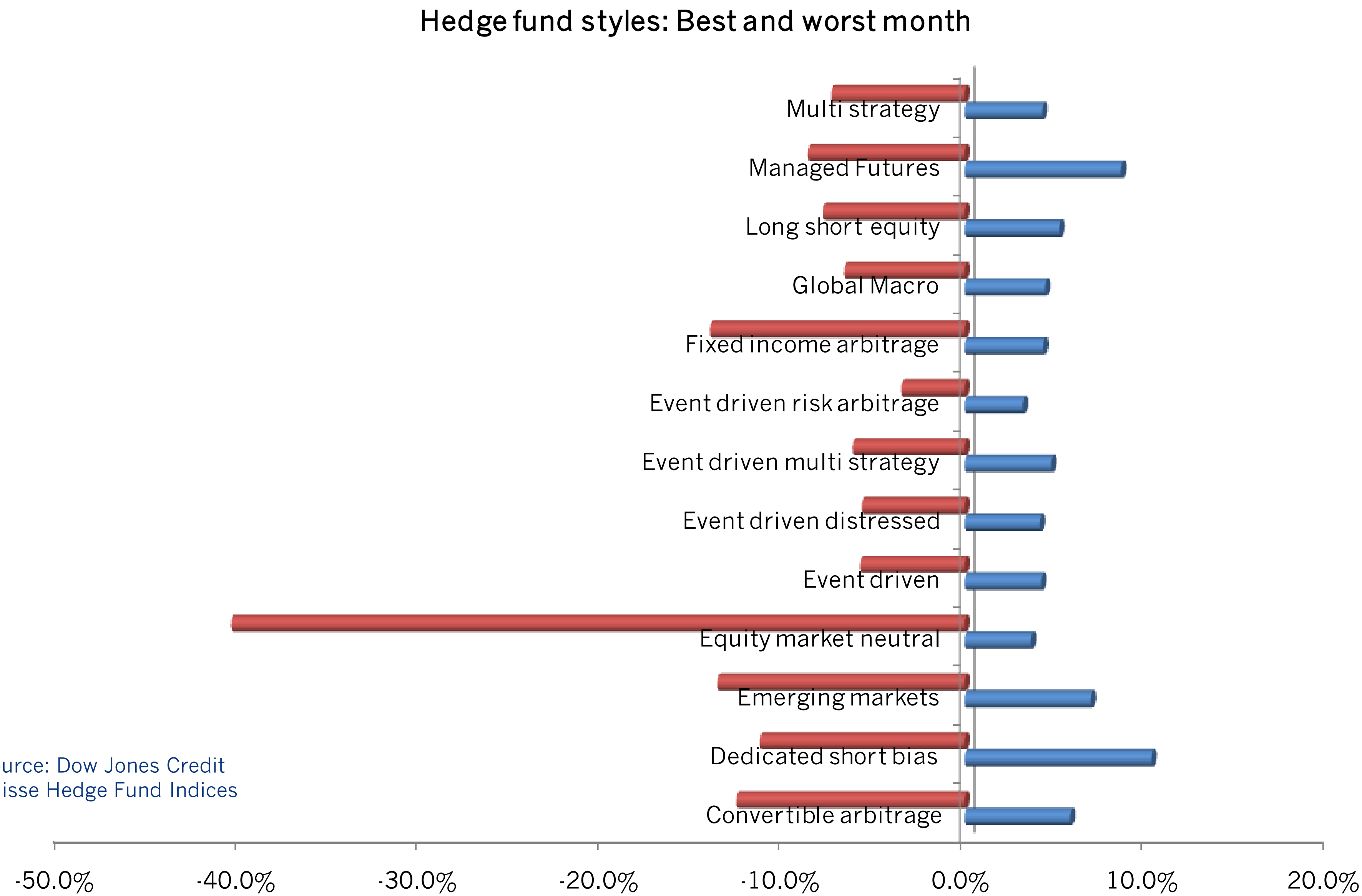
Private equity is an asset class consisting of equity securities in operating companies that are not publicly traded on a stock exchange. Private equity investments are primarily made by private equity firms, venture capital firms, or angel investors, each with their own set of goals, preferences and investment strategies, yet each providing working capital to a target company to nurture expansion, new product development, or restructuring of the company’s operations, management, or ownership.

not all hedge funds are created equal



Source: Dow Jones Credit Suisse Hedge Fund Indices

not all hedge funds are created equal



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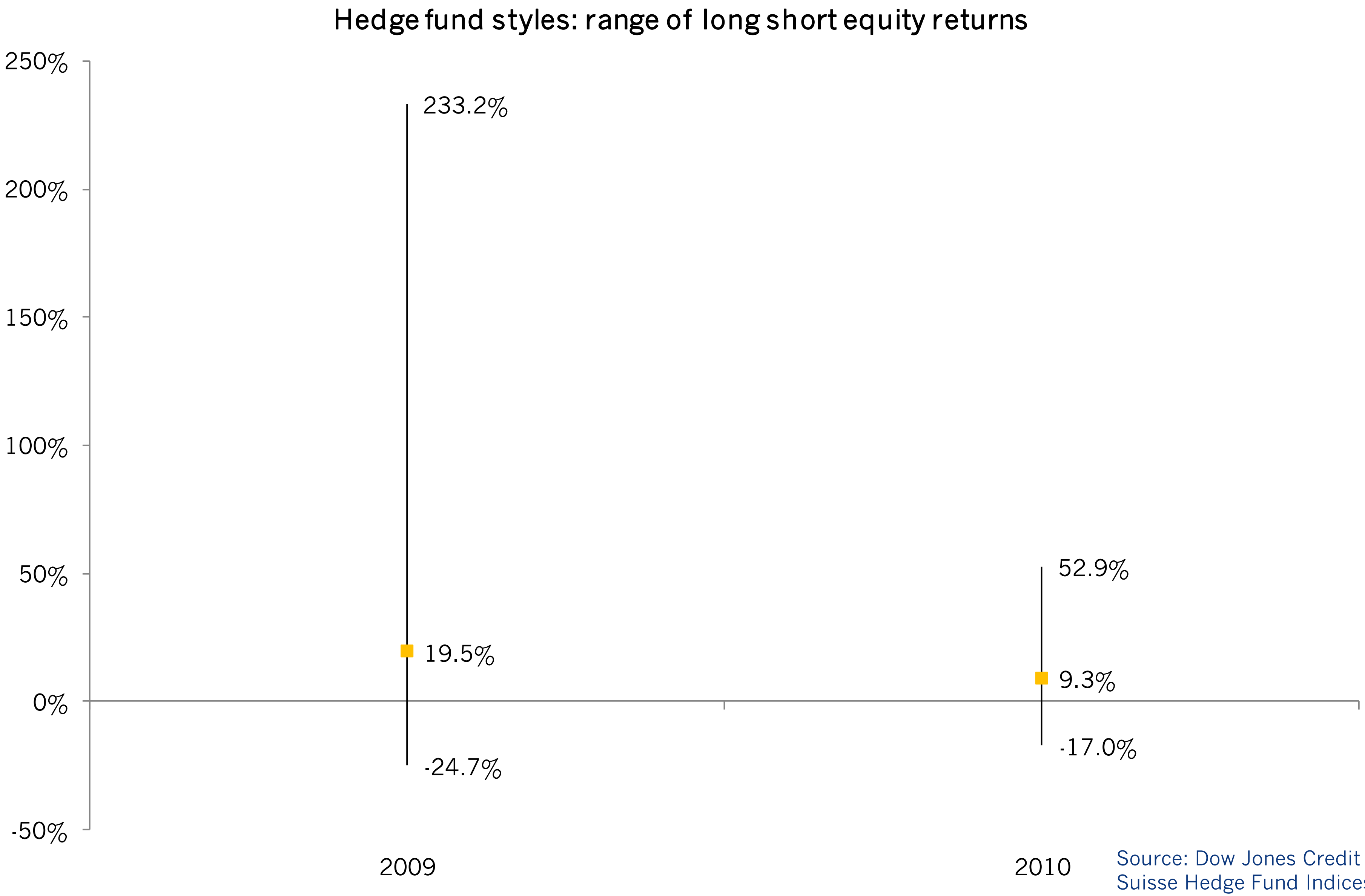
not all hedge funds are created equal



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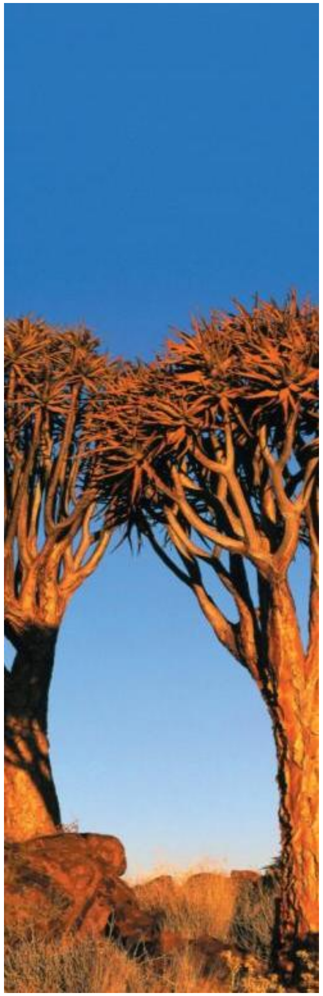
interim

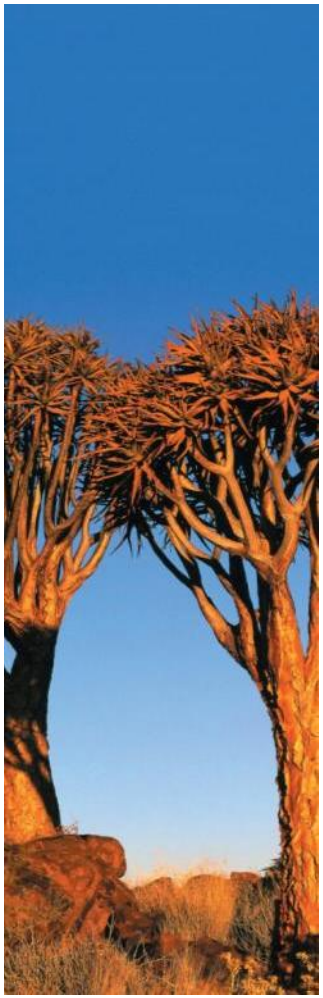


~ investments entered into before 1 April 2011 need not comply with the limits until: -

i. contractual terms are amended

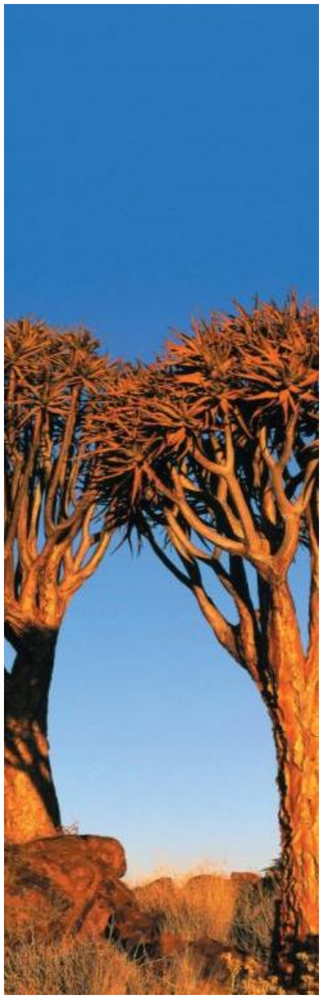
ii. change to underlying assets

the bottom line



- broader limits allow more freedom to develop fund-specific strategies
- greater access to different types of investments – diversification
- trustees will need thorough understanding of what they are investing in and risks
- consequences for administrators / asset managers – compliance at member level and continuously
- broader asset class limits combined with process-based principles will benefit members

things to think about



~ wider range of options ...

emphasis on *options*

~ impact on governance budget

~ key implications:

- ~ review all member choice options
- ~ consider reporting requirements – discuss with administrator / asset managers
- ~ compliance with CISCA is not compliance with Reg 28
- ~ need to look through all structures, consider prior use of debentures
- ~ impact on risk

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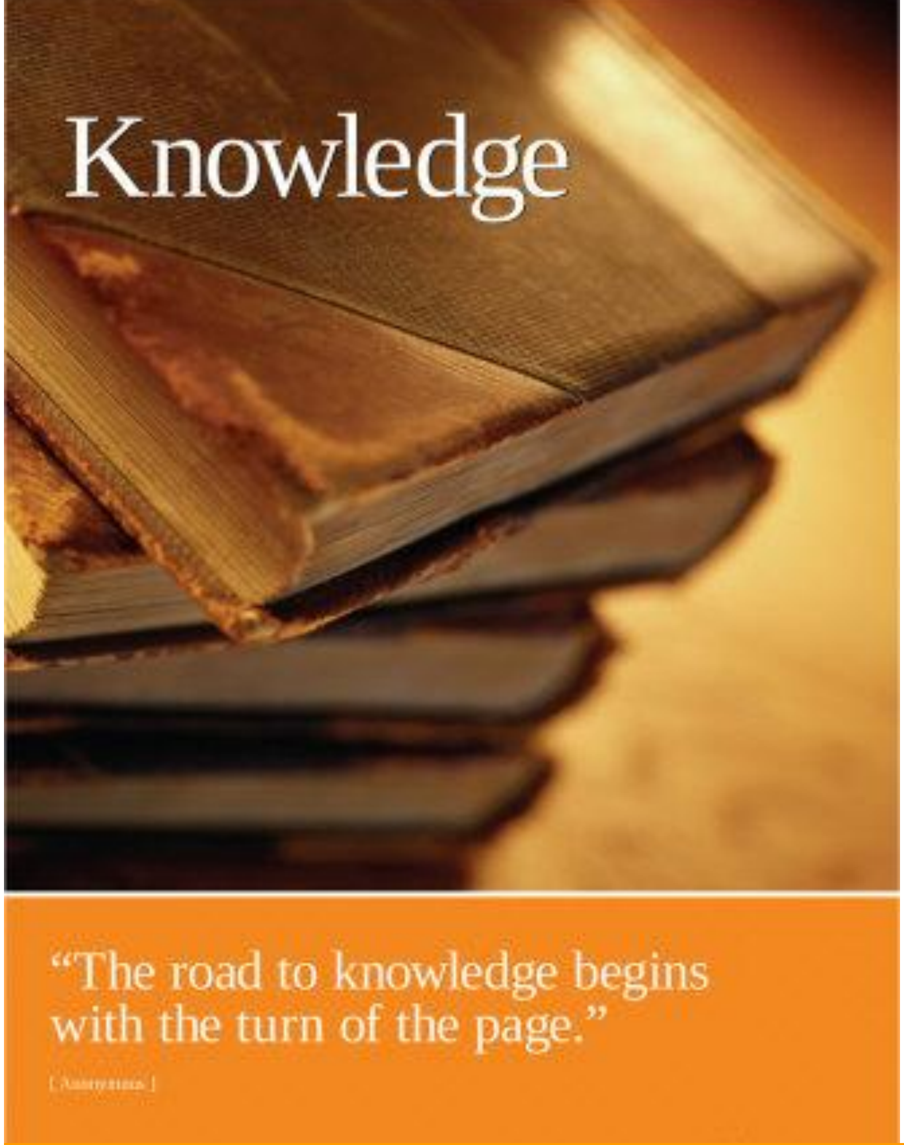

“An investment in knowledge pays the best interest.”
Benjamin Franklin