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PRIVATE EQUITY SECTOR **ALERT**

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Regulation 28 of the Pension Funds Act: Second draft amendments published by the National Treasury for public comment

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Regulation 28 of the Pension Funds Act: Second draft amendments published by the National Treasury for public comment

The proposed review of Regulation 28 is intended to encourage increased investment in infrastructure given the current low economic growth climate.

On 2 November 2021 the National Treasury published the second draft amendments to Regulation 28 of the Pension Funds Act 24 of 1956, which have been updated to address certain submissions from the retirement fund industry on the first draft published in February 2021.

Regulation 28 aims to mitigate concentration risk to member savings and ensures protection by limiting the extent to which retirement funds may invest in a particular asset or in particular asset classes. The proposed review of Regulation 28 is intended to encourage increased investment in infrastructure given the current low economic growth climate.

While investment in infrastructure is permitted under the current Regulation 28, the regulation does not currently define or measure "*infrastructure*" as a specific category. The proposed amendment therefore introduces a definition of infrastructure to enable better measurement of a retirement fund's exposure to infrastructure assets, and also proposes that the overall investment in infrastructure across all asset categories may not exceed 45% of the aggregate fair value of the total assets of the fund (including a limit of 10% in respect of infrastructure in the rest of Africa). The amendment also introduces a limit of 25% to a single issuer or project.

To further enhance investment in infrastructure, the asset category related to "*hedge funds, private equity funds and other assets not referred to in this schedule*" has been split into "*hedge funds*", "*private equity*" and "*any other assets not listed in this schedule*" as stand-alone asset classes.

Currently, "*hedge funds, private equity funds and other assets not referred to in this schedule*" is a single asset class with a collective limit of 15%. Private equity on its own has a limit of 10%; hedge funds of 10%; and other assets not referred to in this schedule of 2,5%. After delinking the asset class group, the overall limit for private equity funds is proposed to be increased to 15% (with a limit of 10% per fund of private equity funds, and a limit of 5% per private equity fund). Hedge funds and other assets not referred to in this schedule would remain unchanged at 10% and 2,5%, respectively. The overall or collective limit is being removed. The National Treasury has indicated that the proposed increase in the limit applicable to private equity is based on a number of studies which document that private equity investments in infrastructure projects have a positive impact and help in sharing project risk between the project sponsors.

It is proposed that the definition of "*hedge fund*" be amended to have the same meaning as that prescribed in the declaration of hedge fund business as a collective investment scheme in terms of Government Notice 38503 of 25 February 2015. As such, the draft amendments propose to only permit investments in hedge funds regulated as collective investment schemes.

The definition of "*Infrastructure*"

The National Treasury received comments from the retirement industry following publication of the first draft of proposed amendments to Regulation 28, and while most submissions welcomed the proposed amendment of the regulation, there were also a number of the concerns raised by the retirement fund industry, which have now been addressed in the recently published second draft.

Regulation 28 of the Pension Funds Act: Second draft amendments published by the National Treasury for public comment*...continued*

The second draft revised the proposed definition of "*infrastructure*" to mean "*any asset class that entails physical assets constructed for the provision of social and economic utilities or benefit for the public*".

One of the major concerns on the first draft related to the proposed definition of "*infrastructure*". The first draft proposed that Regulation 28 use the same definition for infrastructure as that in the Infrastructure Development Act 23 of 2014, in which it is defined to include "*installations, structures, facilities, systems, services or processes which are strategic integrated projects or part of the national infrastructure plan*". Given the specific reference to infrastructure that is "*part of the national infrastructure plan*", the concern was that the proposed definition is too restrictive as it excludes private sector infrastructure projects and infrastructure projects in the rest of Africa. It seemed to only allow for investment into government infrastructure projects.

In response to this concern, the second draft revised the proposed definition of "*infrastructure*" to mean "*any asset class that entails physical assets constructed for the provision of social and economic utilities or benefit for the public*".

The National Treasury stated that this definition takes better account of the United Nations' Principles for Responsible Investment and the input from Association for Savings and Investment South Africa. The "*social*" aspect of the definition is intended to accommodate impact investing by retirement funds. Impact investments are investments made to generate positive, measurable social and environmental impact alongside a financial return. The wider definition also includes private sector infrastructure projects and therefore allows for a larger number of projects that retirement funds can consider for investment.

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The second draft eases the reporting requirements and provides for reporting only on the top 20 infrastructure investments by a retirement fund.

Infrastructure investment limits

With regard to the proposed infrastructure investment limits contained in the first draft, some submissions argued that the limits were too low, and others that the limits were too high, or that the adjustments were not going to impact infrastructure investment by retirement funds. The second draft, however, retains the proposed infrastructure investment limits as contained in the first draft (namely an overall limit of 45%, including a limit of 10% in respect of the rest of Africa, as well as a limit of 25% per issuer/project).

Reporting requirements

The first draft required retirement funds to provide reports on their investment in infrastructure and concerns were raised that this requirement would be too onerous. The second draft eases the reporting requirements and provides for reporting only on the top 20 infrastructure investments by a retirement fund. It is also worth noting that a retirement fund need not apply the look-through principle in respect of the underlying assets of a hedge fund or private equity fund, except in the case of infrastructure investments (i.e. any indirect exposure to infrastructure assets through a hedge fund or private equity fund must be considered in determining compliance with the prescribed limits).

Restriction on crypto assets

The second draft also introduces a new restriction in Regulation 28 on retirement funds' investment in crypto assets as these assets are seen to be very high risk. This restriction is in line with the Intergovernmental Fintech Working Group policy proposal that collective investment schemes and pension funds not be allowed to have exposure to crypto assets until further notice.

The draft regulation define a "*crypto asset*" as "*a digital representation of value that is not issued by a central bank but is capable of being traded, transferred or stored electronically by natural and legal persons for the purpose of payment, investment and other forms of utility; applies cryptographic techniques and uses distributed ledger technology*".

A copy of the second draft amendment is accessible here. The public has until 16 November 2021 to comment on the second draft amendments. Comments can be sent to Basil Maseko at retirement.reform@treasury.gov.za in the prescribed format. Any questions of clarity can also be emailed to that address.

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