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Could a revised regulation 28 be the end of the trend to invest in multi asset funds?

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Regulation 28 of the Pension Funds Act has been in the news in recently since the ANC put the idea of tapping pension to fund various projects, onto the party agenda and included it in its 2019 manifesto.

The regulation sets out prudent investment limits for retirement funds and there are fears that changes may be made to force funds to invest in projects identified by the government. During previous periods of prescribed assets returns suffered.

The COVID-19 induced market and economic crisis has seen the idea of changing the regulation to allow funds to support more unlisted infrastructure projects – but not necessarily force funds to invest in them - garner support from both the finance minister and the president.

News of continued corruption by government officials during this time has naturally made investors' worried that their life savings will be pilfered away by corruption and incompetence.

Investors face a conundrum now with the prospect of changes to regulation 28 looming, and the fact that retirement fund contributions are a meaningful tax planning option.

Contributions to a retirement fund up to 27.5% of the greater of remuneration or taxable income, to a maximum of R350,000 are deductible from taxable income. Returns inside a retirement fund are also exempt from various taxes making them an important component of any retirement portfolio. But tax efficiency will matter little if investors expect their savings to be looted. Regulation 28 boosted a trend towards investing in multi asset funds - unit trusts which invest in a combination of asset classes such as equities, bonds, cash, and listed property.

The most popular of the multi asset funds are those that comply with limits of regulation 28 – known as balanced funds - and can be used by retirement fund investors. At the end of December 2000, multi asset funds comprised just over 11% of unit trust investments. Today multi asset funds comprise 48% of the R2.5trn invested in unit trusts.

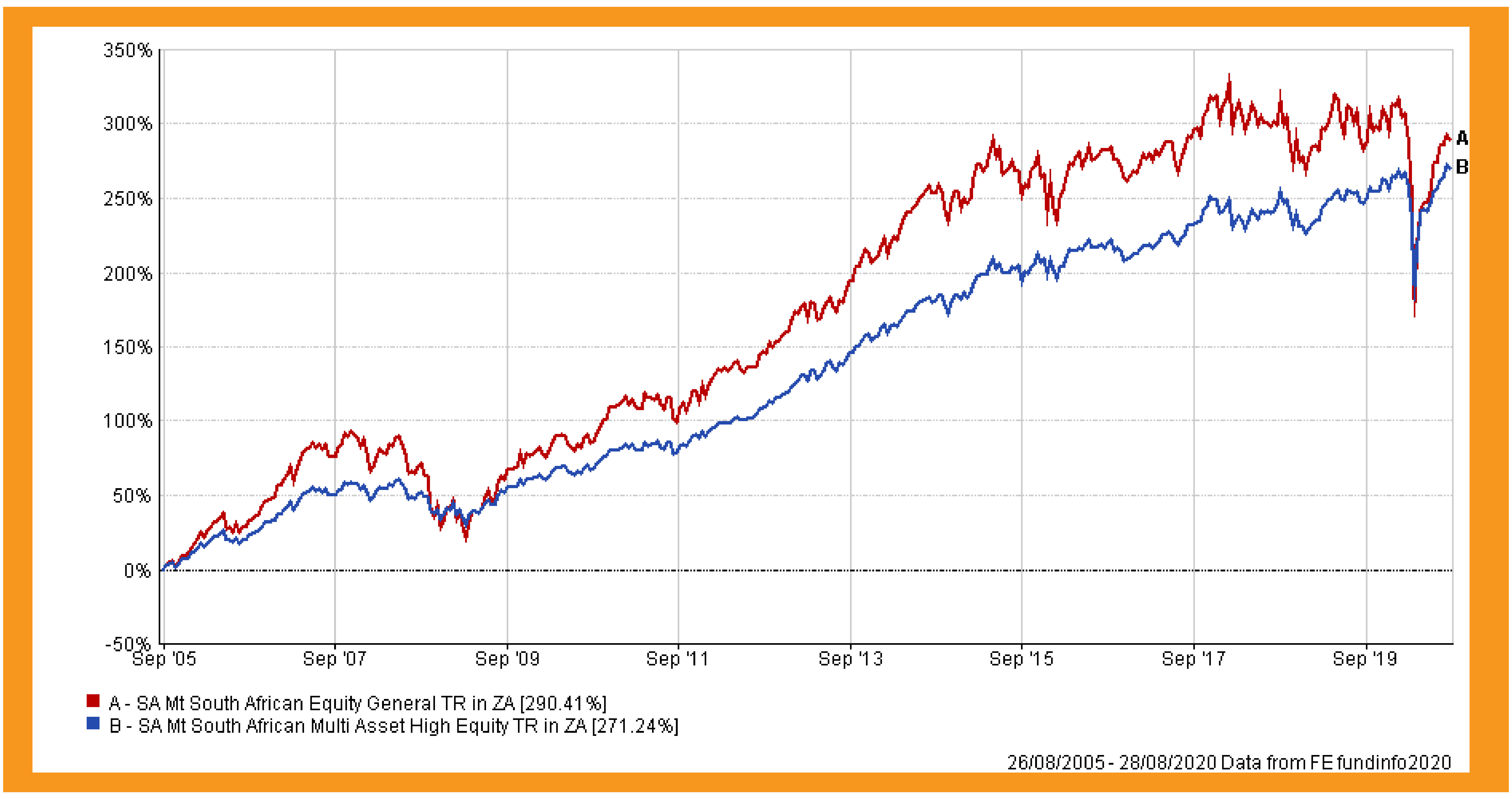
The trend to invest in multi asset funds was driven in part by the introduction of capital gains taxes in October 2001 and the Financial Advisory and Intermediary Services (FAIS) Act in 2002. The former discouraged aggressive switching between funds and sectors, and the latter made it easier for investors to hold financial advisers to account for poor investment decisions.

The 1990's were characterized by investors chasing winners in various sectors including small caps, global technology and gold as those sectors outperformed.

In 2011 balanced funds got a further boost from a change to the way in which regulation 28 of the Pension Funds Act was applied.

Product providers were required to ensure that every investor's retirement fund, retirement annuity and preservation fund was compliant with regulation 28. Until then the requirement was for the provider to ensure the aggregate of all the investments in a fund complied with regulation 28. Some investors' accounts within a retirement annuity did not comply but were offset by other accounts which were conservatively invested. Accounts which were not compliant were given "grandfather" status and allowed to remain non-compliant but all new accounts had to comply. If investors in any grandfathered accounts made changes to the underlying portfolio, they also had to make their entire portfolio compliant with regulation 28.

Regulation 28 limits funds to a maximum investment in shares of 75%, in listed property of 25% and offshore of 30%. These limits apply to employer and individual funds. Balanced funds have been good to investors over the years delivering a similar return to shares over the past 15 years, with noticeably less volatility.



26/08/2005 - 28/08/2020 Data from FE fundinfo2020

A less obvious benefit of balanced funds is that the lower than equity volatility increases the likelihood that an investor will remain committed to the strategy as they do not have to endure the psychological stress of an excessively large capital loss during a market crash.

An option that investors may explore to by-pass potential changes would be to move away from having balanced and other regulation 28-compliant multi asset funds as the underlying portfolio in their retirement annuities and preservation funds, and rather invest in single asset funds.

So instead of investing in number of balanced funds, investors would invest in equity, property, bond, cash and offshore funds in proportion to their need and appetite to take risk. You would still need to comply with regulation 28 until potential changes are introduced. Hopefully, there will be another form of grandfathering that allows investors to avoid ongoing compliance. If investors remain in balanced funds that are regulation 28 compliant, those funds may be required to become compliant with the new limits and requirements.

There is no need for retirement fund investors to make changes at this stage. There is still a process that needs to be followed before any changes to regulation 28 can be implemented. Regulation 28 is an administrative law that requires that National Treasury to first release draft proposed changes for industry comment.

Advisers will know what is being proposed before amendments are gazetted into law and will have a chance to adjust your investments before any changes take effect.

You also need to keep an open mind on potential changes. There are suggestions that changes will be limited to introducing a minimum allocation to infrastructure investments.

Depending on how they are structured, some infrastructure investment opportunities may actually be beneficial for retirement fund members in the long run. Private infrastructure investments have delivered good returns in the past.

Craig Gradidge is co-founder of Gradidge-Mahura Investments and holds the Certified Financial Planner® designation.