ISSUE 14 / September 2018

Dear Subscriber

With South Africa's pension fund asset pool of around R4 trillion, which is approximately 75% of the country's GDP, our pension funds are no doubt a potential powerhouse in the drive to promote economic growth and social transformation across the landscape of South Africa.*

It is undeniable that even though South Africa has made progress, we still face the challenges of unemployment, inadequate and insufficient healthcare facilities, decent education, and a shortage of critical infrastructure. There remains people in our country who do not have access to electricity and water, and the further you move away from the big metropoles, the greater these challenges become.

It is plausible and the opportunity does exist for pension funds to significantly contribute to the South African economy without losing sight of their responsibility to their members. The question is, how easy is it for a pension fund to become that catalyst for change considering the regulatory framework? It's a tricky question with a complex multi-dimensional answer.

To protect pension fund members, the majority of a pension funds' assets (and rightly so) are invested in highly regulated and in many instances mature asset classes. This translates into pension funds investing mostly into listed companies either directly or indirectly through unit trusts and/or multi-managed portfolios; and although listed companies contribute vastly to the South African economy, a pension funds ability to use this asset class in becoming a catalyst is limited for the following reasons:

Firstly, listed JSE shares as a regulated asset class may boost short-term profit-taking, but it diminishes the asset owner’s (pension fund) ability to influence the listed investee company's tangible contribution to SA's economic and social development, and long-term sustainability.

Secondly, Regulation 28 of the Pension Funds Act stipulates a 30% cap on ex-SA exposure (25% international; 5% Africa). The reality, however, is that the actual ex-SA exposure for the current pension funds is substantially higher. Many of the "local" listed companies are more global in nature due to their push for increased geographic diversification, growth, access to technology, and foreign-currency earnings. This is illustrated by the composition of the JSE where approximately 65% of revenue generation by the listed companies comes from abroad. Examples of such companies are Anheuser-Busch InBev, Naspers, Glencore, Sasol, British American Tobacco, MTN, and so on.

Lastly, 60% of South Africa's economic activities and a sizeable portion of the domestic investment (both listed and unlisted) are concentrated around the four main cities of Johannesburg, Durban, Pretoria, and Cape Town. This concentration of investment (and risk) has increased urban migration at a faster pace than what the system can manage.

Many people come to the cities looking for opportunity only to find themselves sucked into the social ills perpetuated by high unemployment in the over-burdened centers. Decentralising domestic investment from the main cities into the secondary towns of South Africa can stimulate the economy to a greater degree than is already the case. There are ample investment opportunities available in these areas to do so that can counter the social burdens experienced in the cities. This must be considered against the backdrop that the membership of the largest South African pension funds is evenly split across South Africa's nine provinces, but their savings are funneled into the four main cities as a default because of the high exposure to the highly regulated listed market. In effect, most economic investments made by pension funds that affect the quality of life take place outside of the areas many of their members will retire to and where their families live.

Also, while most pension funds are, or have, started mapping their portfolio to environment, social, and governance (ESG) requirements, they are not yet necessarily connecting it to transformation goals and "proudly South African" objectives. To do so would need accountability and reporting along the investment chain to include details like "how many jobs did my investment create", "how did my investment improve South Africa's global competitiveness", "to what extent did my investment provide economic growth outside of the key metropoles", and so forth.

What then are the opportunities for pension funds to bolster the economy and drive social change whilst ensuring a return on investment for its members?

To start, pension fund owners need to see themselves as vital catalysts for change. Secondly, they need to actively seek opportunities where they can drive investment allocations into asset classes that have a direct local, social, and economic impact at market rate returns. These alternate asset classes include private equity, unlisted real estate, venture capital, and private debt funds focused on the middle market and SME's - the main engines of job creation and growth.

Regulation 28 stipulates that pension funds **can invest up to 10% of their portfolio in alternative asset classes,** but current investment across the pension funds **only sit at 2%.**

Increasing allocations to alternate assets can have a real transformative effect on the local economy, but this kind of change needs pension funds to have a louder voice. There are several steps pension funds can follow to achieve this.

1. The trustees of the pension funds can expand their investment policy statement to include the requirement for a portion of the pension funds' assets to be managed by managers who recognise the value of ESG and Transformation, and delivering social returns. Doing so will give pension funds an active voice in their investments, channeling their assets into areas that have both local impact to where their pension members are located, while ensuring market-related returns for its members.

2. Pension funds can ease this process by creating transparency between the board, the investment committee, the investment consultant, and the investment managers, concerning the investment policies and social objectives of the pension fund. These aims could include investments in specific sectors, targeted geographical areas, job creation and retention.

3. Pension funds can also become active participants in fund governance. Unlike listed investments where pension funds invest generally through external fund managers and vote by proxy, investments in private equity, unlisted real estate, and debt give the pension fund an opportunity to actively participate in the governance structures of these funds. This is done by nominating an independent investment committee member and/or an advisory board member who has a clear understanding of the pension fund's investment policy objectives and who can ensure their fiduciary duties to their members are not compromised.

4. Pension Funds can formulate the alternative asset fund strategy in conjunction with the fund manager(s). Global trends have evolved to the point where strategy on

private equity is driven by a coming together of ideas from Government, pension funds and the investment managers. In some instances, pension funds have even gone as far as to co-develop a strategy and help in the formulation of a team to execute the strategy. CalPers in the US is a fund that has successfully yielded its influence to achieve the desired social impact without compromising on financial returns.

When it comes to trustees selecting where to invest the assets of the pension fund, the saying "the whole is greater than the sum of its parts" cannot be more relevant. Each asset class has its place as outlined in Regulation 28, which balances the safeguarding of assets with meeting member objectives. However, the whole is not and cannot be complete unless a part of that selection includes investments in alternate asset classes such as private equity, unlisted real estate, venture capital, and private debts funds. By investing in these alternate assets, the pension funds complete not only the whole, but more importantly, they play that catalyst role in driving both social and economic change within South Africa.

*2018 Global Pension Assets Study by Willis Towers Watson

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