Should SA pension funds allocate more capital to private equity?

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Before the redraft of Regulation 28, the amount of capital SA pension funds could allocate to private equity was ill-defined. This was largely because regulators didn't fully acknowledge the importance of this investment vehicle. Under the revised Regulation 28, pension funds can now invest up to 10% of their total assets in private equity. However, few funds have come close to filling this allocation.

International funds endorse private equity

The largest US pension fund, the California Public Employees' Retirement System, established in 1988 (AUM of USD 214bn, 6th largest worldwide) has actively increased its private equity allocation from 5.1% of AUM, or USD 9.8bn, in 2005 to 14.1% of AUM or USD 33.4bn as at February 29, 2012.

Other examples from the US include:

- the California State Teachers Retirement System (11th largest worldwide), with 14.4% of AUM in private equity (USD 22.1bn) as at March 31, 2012.
- the New York State Common Retirement Fund (13th largest worldwide), with 9.5% or approximately USD 12.6bn in private equity as at March 31, 2011.

The Dutch ABP pension fund, with AUM of USD 318bn, has the largest allocation to private equity in Europe of approximately USD 15bn or 5% of its AUM.

In emerging markets such as Korea, the National Pension Fund (AUM of USD 289bn, 4th largest worldwide) has an allocation of approximately 8% to alternatives which include infrastructure, venture capital and private equity with double digit allocations targeted in the short-term.

The South African situation

At the end of 2010, the South African private equity industry had a total of R97.6bn of funds under management, approximately USD 13bn. While this is small, relative to our developed market counterparts, it is considerable in relation to our GDP at 3.6%.

Despite the regulatory changes promoting increased allocation to private equity, South African pension funds remain underweight with less than 1% of their AUM invested in the category. The existing allocation is mainly driven by the activity of South Africa's largest pension fund, the Government Employees Pension Fund (AUM of USD 128bn, 15th largest worldwide). If this fund's allocation were excluded, little material allocation would exist amongst the remaining SA players.

Private equity has performed well

Performance numbers across the globe support an increased allocation to private equity, especially South African private equity, which has outperformed its developed market counterparts, as shown in the following table:

	10 year	5 year	3 year
SA Pooled IRR	21.7%	21.2%	11.5%
UK Pooled IRR	13.1%	17.3%	4.40%
US Pooled IRR	8.1%	9.1%	1.30%

The relatively greater allocations to private equity by developed market pension funds, coupled with the superior performance of SA private equity over the past 10 years, suggest that SA pension funds are underweight in this category and would do well to increase their exposure to maximise member wealth.

For more information on Regulation 28, **click here**.
To read the full RisCura South African Private Equity Performance Report, **click here**.

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