Catalyst

Pension funds carry the responsibility of providing a means to a comfortable retirement for their members. To fulfil this responsibility, pension fund trustees must make appropriate allocations to asset classes in order to grow the fund's assets to satisfy the liabilities created by the payouts to retiring members.

Proposed regulations will pull the rug out from under private equity funds

Rory Ord

This asset allocation should be done by modelling the fund's assets and liabilities, taking into consideration the fund's risk profile, in an effort to determine an allocation with the highest potential to meet the fund's liabilities over the long term, thus ensuring an avenue to comfortable retirement.

Regulation 28 of the Pension Funds Act 1956 legislates the limitations on the percentage of a fund's portfolio that may be invested in specific asset classes. These regulations have been in place for many years and seek to give structure to asset allocations in an effort to prevent misallocations by pension fund trustees and their service providers. The Regulator has recently put forward draft amendments to Regulation 28 in an effort to update this legislation – to align with current investment practices.

Unfortunately, the draft regulation has created a large degree of uncertainty in South Africa's steadily growing private equity market. These sentiments are echoed by the Southern African Venture Capital and Private Equity Association (SAVCA). Under the existing Regulation 28, private equity is classified into either the "unlisted securities" bucket with a maximum allocation of 5% or the additional 2,5% earmarked for "other assets", which is generally interpreted as allowable for private equity investment. Though this total of 7,5% is considered a small allocation, the regulation is relatively clear and allows investors to plan their allocations and in turn private equity fund managers to plan their funds.

However, the current draft amendments to the regulation do not appear to consider private equity specifically, which leaves it as part of the "other assets" category thus limiting its allocation to 2,5%. Should this draft legislation go ahead, this would effectively reduce the allocation that pension funds can make to private equity by two thirds.

Another way to interpret the draft amendments to the regulation is to include private equity as part of "unlisted securities." However, assets in this category must now, according to the draft amendment, fall into a credit rating band. It is generally accepted that private equity investments cannot be ascribed credit ratings because of the equity nature of these investments.

The move to limit pension fund investment into unlisted assets may have the unintended consequence of hindering economic growth

Furthermore, the proposed legislation does not consider "unlisted investments" outside of South Africa in its categorisation. Many South African pension funds see investing in the rest of Africa as a way to capture growth from these rapidly developing markets. Private equity is a likely avenue for investment into many African countries where stock exchanges are not as developed as South Africa's, and where few companies are listed.

Private equity as an asset class is a valuable part of a pension fund's portfolio as it allows the fund to invest in assets that have a low correlation to listed markets, as well as premium returns**. This value has been recognised by the world's largest pension funds. Many North American pension funds including the California Public Employees' Retirement System, have allocations of more than 10% to private equity, while others have more than 20%*. The Organisation for Economic Co-operation and Development (OECD) surveyed the limits that pension funds are allowed to allocate to private equity in 22 countries. Nine of these countries had no limit, while only 3 had limits as low as 5%. None of the countries surveyed had limits below 5%. Therefore, on a relative basis, the proposed limitation of 2,5% is very low.

Ord

The move to limit pension fund investment into unlisted assets may have the unintended consequence of hindering economic growth, as private equity is a key avenue of financing for small to medium sized companies looking for expansionary capital. A recent survey performed by SAVCA in conjunction with the Development Bank of Southern Africa (DBSA) showed that private equity investment into unlisted companies had an overwhelmingly positive impact on these companies, both in terms of profitability and job creation. The survey showed that more than 50% of the companies surveyed said that private equity investment had facilitated Black Economic Empowerment in their business, while almost half said that private equity finance was actually responsible for the survival of their business. A further, 64% of respondents felt that their companies would have grown less rapidly without private equity investment.

Private equity funds also have several attributes that make them favourable for long-term investments such as infrastructure, which may take many years to develop. Over the last 15 years, private equity investments have funded many such projects, including toll roads, mines and water provision projects.

In addition, the trend in pension fund investment towards sustainable investment, developmental finance and socially responsible investment may be hindered by the proposed regulation changes. The investment base of companies listed on the JSE is simply too small for South Africa's pension funds to invest significantly more in companies that adhere to these ideals. In order to allow pension funds to invest in this way, greater access to unlisted companies must be allowed.

South Africa's private equity industry has grown rapidly over the last 10 years, and now has assets under management of over R100 billion, much of which comes from institutional investors. Reducing the allowed contributions of institutions such as pension funds to private equity will be detrimental to pension funds and their members through lower risk adjusted returns and particularly threatening to the South African economy by reducing the access that small to medium sized companies' have to capital. ◆

Rory Ord is Head of Valuation and Pricing at RisCura Analytics

Even though deal activity in the private equity industry has been muted over the last 18 months the market has welcomed a new player into the mid-market space with the launch of Trinitas Private Equity in the second quarter.

Trinitas looking for mid-cap meals

The independent third party private equity fund was established by three experienced private equity executives Andrew Hall, Soteris Theorides and John Stipinovich, are the funds Principals, with JSE-listed specialist banking and financial services group Sasfin Holdings as a partner and anchor investor.

Peotona Group Holdings, the women's' investment organisation headed by Cheryl Carolus, is the fund's BEE partner.

"Trinitas is a black-empowered, independent private equity advisor, formed as a joint venture amongst the Principals, Sasfin and Peotona Group," explains Hall. "The Principals have worked together as a private equity team since 2001, having previously managed two other independent private equity funds. The Principals' collective private equity experience of thirty-two years, and integral involvement in the majority of the twenty-one deals undertaken in two previous later-stage private equity funds, is the reason that the Fund is promoted as the Principals' third later-stage fund, albeit through the new platform of Trinitas."

Hall says that, despite raising funds in difficult conditions – it was initiated in 2008, coinciding with the collapse in glob-