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# REGULATION 28: HELL HATH NO FURY LIKE VESTED INTERESTS SCORNFED

By Magnus Heystek, Investment Strategist & Director, Brenthurst Wealth

The massive blow-up in the financial services industry relating to the increase (or not) in offshore exposure for retirement funds in general, and retirement annuities and preservation funds in particular, has been a long time coming. In many ways it's an extraordinary situation where Treasury and the SA Reserve Bank (SARB) announce massive changes to the regulatory environment – apparently without direct input from the industry itself – and which has been retracted under immense pressure from certain interests in a massive and powerful industry.

IN ALL OF THIS ONE HAS TO ASK: WHAT ABOUT THE INTEREST OF ORDINARY SAVERS AND INVESTORS?

There is no dispute that so-called mom-and-pop investors have been getting a raw deal in terms of returns over the past seven years and more. Very few savers in retirement funds have seen returns in excess of inflation over this period of time when all costs and fees are included. It's not uncommon for members of the public to forward me RA investment statements from one of the three large insurance companies which have shown no growth in NOMINAL terms over the past five years, mainly due to the high cost structures of these products.

In an era of high returns – now long-gone – it was possible to hide total expense ratios of 3-4% per annum, but not any more. Gross returns on the JSE over the past seven years have been below 5%, which means, after costs, there is not much left for the poor investor.

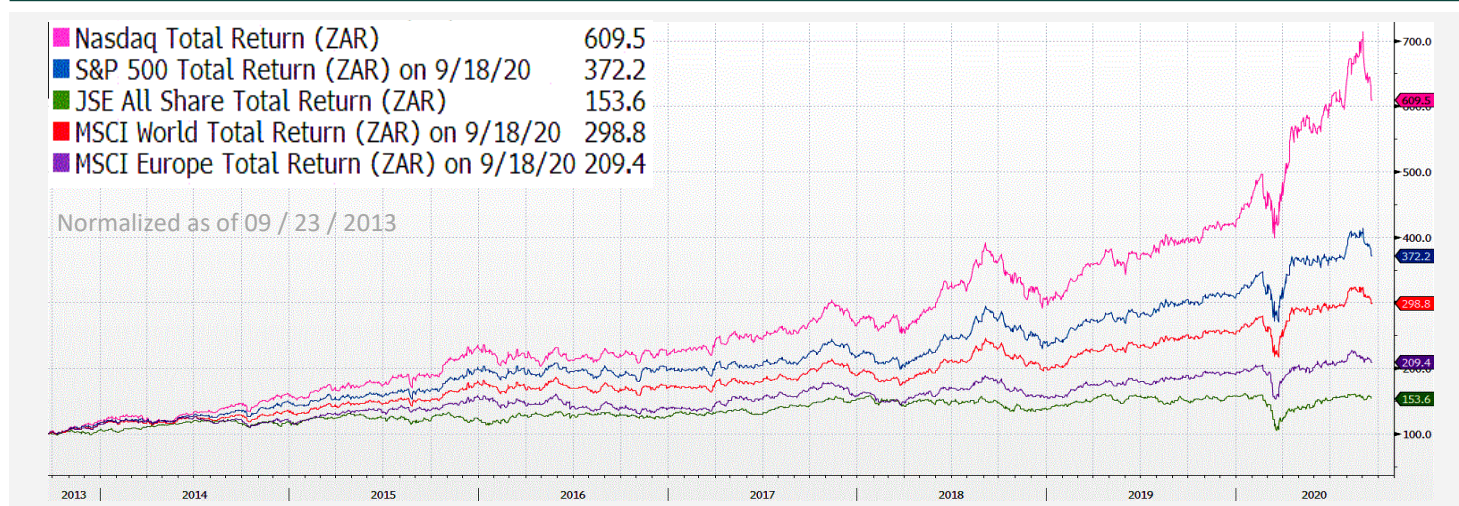
But the issue has many other ramifications which have been building up over many years around the issue: how much offshore exposure is warranted and needed? What will an increase in offshore exposure do to the local market and also the currency?

# A CENTURY OF OUTPERFORMANCE

For more than a century to approximately 2010, investing in the JSE in its various forms was a smart thing to do. Returns, even in dollar terms, were on par with the best of the world according to the seminal study by Credit Suisse in its report, *The Triumph of the Optimists*. For most of that century, SA was the leading producer of diamonds, gold, precious metals and minerals. Towards the end of the century this tailwind had quietened down considerably and, over the past 10 years or more, has dropped down to merely a gentle gust of wind – a classic case of the doldrums.

With these tailwinds gone, from about 2011 onwards the returns on the JSE started lagging, at first marginally, but over the past five to seven years, by a wide margin. Over one, three, five and seven years the returns on the JSE, when compared to global markets, lagged badly. Even the Public Investment Corporation (PIC), SA's largest pension fund, recently said it needed greater offshore exposure to improve investment returns for its members.

## JSE LAGGING THE INVESTMENT RACE



Coincidentally, it was also in 2011 that a new dispensation as far as Regulation 28, in conjunction with exchange control guidelines, were imposed on pension funds and also individual members of retirement annuity and preservation funds.

**IN SHORT: Regulation 28** was decided on, without any consultation from the investing public, I must add – which provided guidelines in terms on maximum asset allocation between equities (75%), property (25%) and 25% in foreign assets. And second, more importantly, these levels were now imposed at fund level and not at individual level. This too, was a major intervention by the regulators, which in my view, has backfired badly. Prior to this the offshore allocation was controlled at fund level: the fund was restricted to 25% offshore foreign exchange exposure, but at individual level (the so-called see through principle) individuals were allowed 100% should they desire it or their ultimate investment objective – such as retiring offshore one day – allowed for such a large offshore exposure.

But in terms of the new Regulation 28, since 2011, all investors were given the same option: you can have any motor car as long as it's black. The so-called Henry Ford option.

This added another layer of administrative complexity and also costs in my view. Those lucky individuals who had a greater foreign exposure were allowed to retain this exposure but could not add to these funds or make changes. These investors have seen their RAs grow by more than double and treble the annual rate of return when compared to the Regulation 28 restricted funds, from the same company. I took these numbers from the Liberty Life website which still publishes the returns of the unrestricted RAs.

**The net results have been a disaster for most, if not all, investors in pension, provident and other personal retirement funds such as retirement annuities and preservation funds.**

But the investment industry, from the word go, fully supported this limitation on foreign investment. On each and every platform it continued to say “25% offshore investing is enough”. And when the offshore allowance was increased to 30% (excluding the 10% permitted for investment into Africa) they continued to justify this imposition.

In a circular dated 1 April 2011 Allan Gray said the following: *“Despite these changes we believe that members of RA and Preservation Funds will still be able to select underlying investments which best suit their risk profile and investment objectives.”*

This was the one-voice commentary from the industry going forward. Regulation 28 is actually a good thing and it protects investors from making bad decisions.

I started raising the issue of Regulation 28 in articles and commentary going back to 2013. Each and every time, such reports were met with massive push-back from the asset management industry. The industry kept pushing the line that an offshore exposure of 30% (excluding Africa) was enough and critics must just shut up.

I often commented, mostly tongue-in-cheek, that any criticism against Regulation 28 from within the investment industry would be a career-ending move.



**We believe that one should take a global view of how to allocate your capital.**

**A portfolio that combines local and offshore assets offers better risk vs. return characteristics over time than a domestic-only portfolio.**

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I spent some time with Dr Google just to make sure of my facts, but I could not find any comment or criticism of Regulation 28, which was progressively impoverishing investors in these very important retirement funds.

**SA INVESTORS WERE MISSING OUT (AND STILL ARE) ON ONE OF THE MOST EXPLOSIVE STOCK MARKET BOOMS IN RECENT TIMES, THAT OF THE SO-CALLED FAANG-STOCKS LISTED ON AMERICAN STOCK MARKETS AND ALSO SOME EXCITING MEGA-THEMES SUCH AS HEALTH CARE, BIOTECHNOLOGY, TECHNOLOGY AND DEMOGRAPHIC FUNDS. INSTEAD, SA INVESTORS WERE LOCKED UP BEHIND REGULATORY TRELLIDORS WITH THE HELP OF A VERY COMPLIANT LOCAL ASSET MANAGEMENT INDUSTRY.**

**Remove two companies from the JSE – Naspers and Prosus – and the investment universe for local investors has been a wasteland of shrinking listings, declining profitability in many sunset industries.**

Most members of pension/provident, retirement funds and preservation funds have made real returns on their investments for over five years now and very marginal returns over seven. There is very little media coverage about this, particularly in mainstream media. I have personally raised this issue with the editors of two national newspapers, only to be told that I am being negative!

As recently as June this year Allan Gray did a webinar where it again tried to argue that, based on very long-term historical returns numbers, 30% was an optimum number for offshore versus 70% invested in local assets. Shaun Duddy, an actuary working on product development at AG, said the following on this particular webinar: *“Offshore diversification can help. According to the analysis of our long-term dataset, investing 30% offshore would have allowed lower volatility while maintaining the same or higher levels of real returns, equaling or bettering the likelihood of success.”*

**The problem of using long-term statistics is that it does not alter the fact that, due to a lethal combination of a downward move in the commodity cycle (2011 onwards) together with state capture and economic mismanagement, the returns on the JSE over the past 10 years have been disastrous. There are also no verifiable facts to support the contention that the JSE will soon return to its long-term averages.**

It is like an undertaker pointing to a corpse on the dissection table, saying: For the first 10 years of its life this body had an average heartbeat of 100, and in the second ten years it was dead. So, ergo, the average heartbeat over 20 years was 50.”

My first reaction when reading the circular from the SARB was that this was brilliant news for individual members of RAs and preservation funds who could now get access to low cost, 100% offshore exchange traded funds which have been performing absolutely brilliantly. Into this very small opening in the formidable line of defence of the local asset management industry jumped diminutive but fearless Magda Wierzycka, founding CEO of Sygnia Asset Management, who just happens to be one of the largest (if not largest) offeror of inward-listed offshore ETFs, courtesy of its purchase some years ago of the Deutsche Bank ETFs listed on the JSE.

Others that stand to benefit from this apparent change in legislation would be Satrix (owned by Sanlam), but Satrix has been remarkably quiet on this issue. The large players in the investment industry were left out in the cold, as the circular only referred to exchange traded funds and not asset swap funds, and they therefore stood to lose out, big time, as they say.

She got a legal opinion from ENS which concluded that that there is nothing in the circular or in the myriad of laws and regulations that prevents Sygnia from offering 100% exposure to offshore ETFs within RAs and preservation funds. But this was like provoking the proverbial hornet nest and standing by to see what comes out. And boy, did it come out!

Asisa, after some further prodding by Wierzycka – a member of the body but who was never consulted – was eventually forced to release its email to the Financial Services Conduct Authority (FSCA), which has now culminated in the circular being withdrawn by Treasury and the SA Reserve Bank, pending further consultations between affected parties.

## PUBLIC PARTICIPATION

But at best this whole blow up was needed for all these issues to be aired in public and not discussed behind closed doors, away from the inquisitive eyes of the investing public. Public participation in the determinations of Asisa, in my view, has been minimal or non-existent.

**Here is an opportunity for the public to get involved in the whole issue of Regulation 28, the 30% offshore limitation, the choice of investment instruments, and the low returns earned on retirement funds over the past 10 years, which Treasury and the investment industry have been studiously ignoring.**

**Now is the time for rapidly-impooverished retirement fund members to get involved. You have until 15 Dec 2020 to do so and the email address to use to make your representation is [sarbportfolio@resbank.co.za](mailto:sarbportfolio@resbank.co.za).**

This is the time to make your feelings known. These openings are rare and every fund manager, investor and investment advisor needs to get involved and convey their views on this issue.

I know what my view is likely to be: we urgently need more offshore exposure at the cheapest possible price.

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