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REG 28: HOW LIMITED OFFSHORE ALLOCATION AFFECTS RETURNS

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Most investors in pre-retirement products are aware of what **Regulation 28** is. In short, a restriction on the allocation of the investment into various asset classes, mostly the better performing one namely offshore assets.

Despite the existence of Regulation 28 of the Pension Fund Act many funds have delivered acceptable returns for investors, but adding just a little bit of risk can make a big difference in the overall return achieved. Considering the investment, it is especially younger investors, with decades of saving ahead, who are losing out the most.

Regulation 28 was officially implemented on 1 July 2011. To understand its impact, herewith an analysis of how the restriction has cut into the performance of an investor's retirement fund versus a discretionary portfolio, which is subject to exchange controls.

To do this we have devised an optimal portfolio over the last eight years with the use of the mean-variance optimisation-method.

This is a quantitative tool that allows for optimal allocation by considering the trade-off between risk and return. This optimal portfolio for the period of eight years, has 100% offshore allocation *(page 2).*

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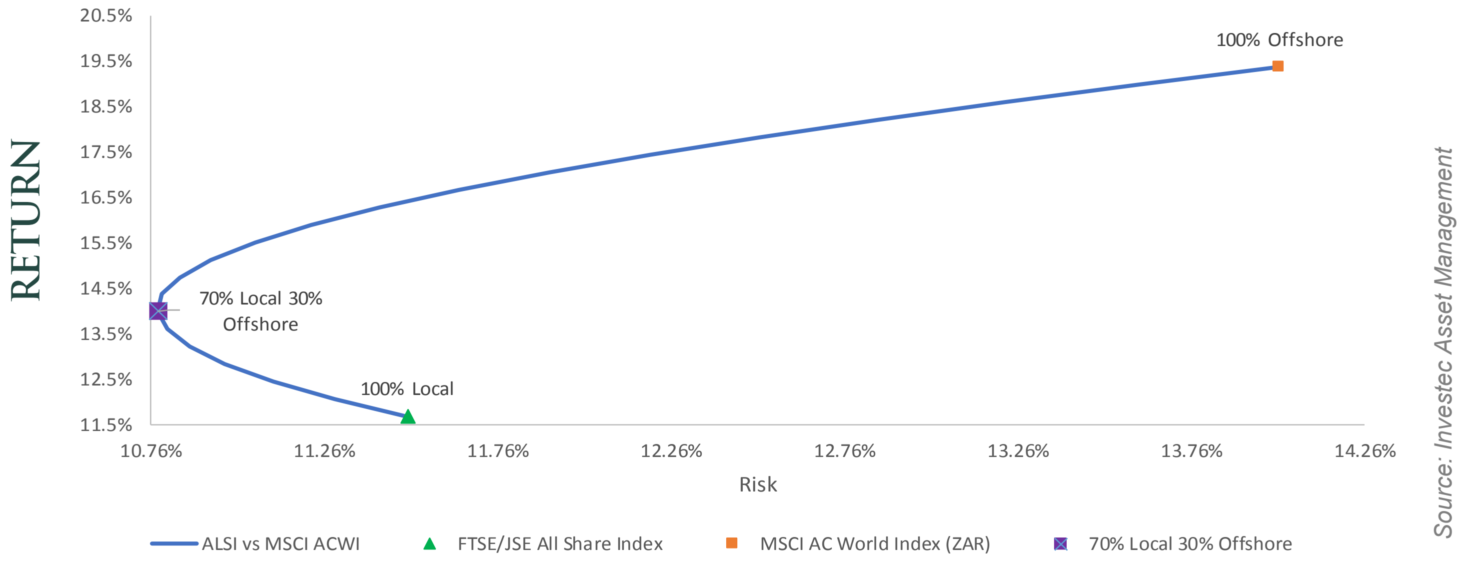

Even though the Regulation 28 portfolio shows the lowest risk rating, the investor in this portfolio would have had a substantially bigger return, with a slightly higher risk, compared to an investor who invested all money abroad over the last 8 years.

PORTFOLIO ALLOCATION	LOCAL ASSET	GLOBAL ASSET	RETURN	RISK (%)
0 OFFSHORE	**100%**	**0.00%**	**11.6%**	**11.5**
70/30 LOCAL / OFFSHORE	**70%**	**30%**	**13.9%**	**10.78**
100 OFFSHORE	**0%**	**100%**	**19.3%**	**14.01**
OPTIMAL PORTFOLIO	**0.%**	**100%**	**19.3%**	**14.01**

Source: Investec Asset Management

The reasons for investing offshore is compelling and include diversification benefits, reduced emerging market and currency risk, and maintenance of 'hard' currency spending power.

BUT HOW SHOULD INVESTORS GO ABOUT INVESTING OFFSHORE?

The answer depends on investors' personal circumstances, risk profile and longer-term financial planning objectives. It is therefore imperative to consult a financial advisor who can help identify investment solutions that address an investor's specific requirements.

There are many options available. A unit trust, that includes offshore assets, like a regulation 28-compliant multi-asset or balanced fund is allowed to invest up to 30% in international assets.

By making use of this type of fund, investors are effectively appointing a professional money manager who has the time, experience and access to information to decide when and how much to invest offshore on their behalf, and into which assets.

But that might not be the most efficient solution for everyone. Perhaps an unconstrained investment mandate improves the return characteristics of a multi-asset (balanced) portfolio at only marginally higher risk. That is where a rand-denominated international unit trust is a better option.

It is a direct investment into underlying funds and investors don't have to make use of their individual offshore allowance. Rather, they invest in rand and when they disinvest, the proceeds are paid in local currency as well. However, the investors benefit from offshore exposure, but South African political risk remains.

That is where an investment in a foreign-domiciled international unit trust could be a better option, where savings go directly into international funds in its dealing currency e.g. dollars, pounds or euros. Many South Africans have favoured rand-denominated international funds because of the perceived complexity of applying for tax and Reserve Bank clearance to invest offshore directly.

However, now that investors can invest up to R1 million annually in an international fund without the need for any prior approvals, they can access foreign-domiciled international funds with relative ease and thereby diversify away from South African political risk.

In addition to the annual discretionary allowance of up to R1 million, investors also have a foreign investment allowance of up to R10 million per calendar year (a total sum of R11 million). Investors need to obtain foreign tax clearance from the South African Revenue Service if they wish to use this allowance.

BRENTHURST WEALTH has a number of global funds available in its suite of investment options, for instance the MI-PLAN GLOBAL IP OPPORTUNITY FUND, which has delivered returns of CPI plus 9% for the past 12 months.

It is important to always remember that each investor's situation is different and circumstances relevant to a particular individual must be considered for any retirement plan.
It is advisable to consult a qualified, accredited, experienced advisor to navigate the options.

CONCLUSION

It is a strong recommendation from Brenthurst Wealth that investors older than 55 who have money invested in either a retirement annuity (RA) and/or preservation fund move their money out of these Reg28 funds. Most investors are often not aware how poorly these investments have done over the past 3-5 years. In most cases these investments have not even beaten the inflation rate. This is a serious threat to your ultimate retirement capital and future standard of living.

The large asset management companies will try their hardest to convince investors not to do so, but this is advice is in their interest and not yours.

Both these investments can be matured and the capital transferred to a living annuity, which is not bound by the restrictions of Reg28. We also only recommend moving the money to investment platforms that allow investors 100% offshore allocation. Many large investment houses, including Allan Gray, only allow a limited offshore exposure. We feel this is not in the best interest of our clients.

Another option with preservation funds is a total withdrawal but such an option needs careful consideration as it involves a large tax penalty. However, in certain instances investors are prepared to pay that penalty in order to get access to their capital.

MOVING THE MONEY AWAY FROM REG28 FUNDS HAS ANOTHER ADDED BENEFIT: INVESTORS CAN THEN GAIN ACCESS TO SOME OF THE BEST INVESTMENT FUNDS IN THE WORLD AT A MUCH LOWER COST.

Speak to any of our offices countrywide to start this process. You won't be sorry.

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