CHANGES TO REGULATION 28

MERGENCE
INVESTMENT MANAGERS

Welcome changes to Regulation 28 relating to infrastructure investment

On 5 July, National Treasury published long-expected amendments to Regulation 28 of the Pension Funds Act*, providing definitions, and setting out limits and conditions for pension funds wishing to increase their allocations to various asset classes and instruments under a broad infrastructure investment umbrella.

The final amendments come after two rounds of public consultations and comments in 2021 and will focus on creating a regulatory framework that will take effect on 3 January 2023.

The detail is potentially complex but in summary the amendments include:

- Common definition of infrastructure;
- Overall exposure of 15% to infrastructure investment across all asset classes, excluding debt issued or guaranteed by the government;
- Separate limits for both private equity and hedge fund investments;
- Introduction of a single-entity exposure limit of 25% across all asset classes;
- Explicit prohibition of investment in crypto assets by pension funds; and
- Changes to infrastructure-related reporting requirements.

CLICK HERE *to view a summary of the new Regulation 28 asset class limits.*

Infrastructure Investments are now defined as: *"any asset that has or operates with a primary objective of developing, constructing and/or maintaining physical assets and technology structures and systems for the provision of utilities, services or facilities for the economy, businesses, or the public"*.

Funds can now allocate up to **15% of their fund exposure** to unlisted infrastructure investments through infrastructure **focussed private equity funds** and up to **15% exposure** to unlisted infrastructure debt through **direct exposure or private infrastructure debt funds**. Funds can allocate an additional **15% exposure** to **listed infrastructure** assets (debt and/or equity).

In a welcome step, hedge funds and private equity have been spun off from each other: **private equity** now has a separate **15% limit**, with a separate **10% allocation** to **hedge funds**.

No specific allocation has been made for private debt funds, but the 15% limit for all debt not listed on an exchange remains. This implies that if a fund were to use its full **45% allocation** to infrastructure, at most **30%** could be through **exposure to unlisted assets** with the remaining **15% limited to listed infrastructure** bonds and/or equity. This may lead to an increase in new listings of infrastructure focussed debt or equity instruments to take advantage of this allocation.

Regarding a stricter reporting regime, we welcome the changes to **infrastructure-related reporting requirements**, given the higher risk element of most unlisted assets. Over the years we have honed a high degree of skill in due diligence and, more recently, a best-in-class ESG integration into our private markets investment process. This process enhances the ability to provide risk-adjusted returns while making a significant and positive impact on society and the environment.

Reporting changes are summarised as:

- Private equity funds, which are usually exempt from look-through reporting requirements, will be required to specifically report on infrastructure exposure.
- Funds will be required to report on infrastructure exposure on an aggregate basis across the fund as per the table below.

Categories of assets	Percentage (Infrastructure) (%)	Rand value (Infrastructure) (R)	List of Top 20 holdings in respect of infrastructure (name of issuer / entity in respect of infrastructure)
1. Cash			
2. Debt Instruments including Islamic debt instruments: 2.1 Debt instruments issued by, and loans to, the government of the Republic and any debt of loan guaranteed by the Republic 2.2 Other debt instruments: 2.2.1 Listed debt instruments 2.2.2 Unlisted debt instruments			
3. Equities: 3.1 Listed equities 3.2 Unlisted equities			
4. Immovable property (direct and indirect)			
5. Commodities			
6. Investment in the business of the participating employer			
7. Housing loans	n/a	n/a	n/a
8. Hedge funds			
9. Private equity			
10. Other assets not referred to in this table			
11. Infrastructure exposure in the rest of Africa			
TOTAL (Total investment in respect of direct infrastructure, excluding debt instruments issued by, and loans to, the government of the Republic and any debt loan guaranteed by the Republic	**%**	**R**	

Mergence infrastructure funds

In summary we welcome the amendments to Regulation 28, specifically the infrastructure investment limit which encourages retirement funds to invest in infrastructure projects. The new 45% allowance opens up more opportunities for retirement fund trustees to consider infrastructure projects.

With the vision of "creating shared value" and defining itself within the national discourse around structural issues in South Africa and the broader SADC region, we were pioneers in impact/infrastructure investing, with our first socially responsible fund range launched in 2010 and our first infrastructure equity fund in 2015. We have a suite of four innovative infrastructure-focused funds investing across both debt and equity, into sectors spanning renewable energy (16 plants across wind and solar), affordable housing, water, financial inclusion (via SSME support), transport, and health.

Following the highly successful strategy of Mergence's Infrastructure & Development Equity Fund which has consistently outperformed its benchmark of CPI + 7% since inception while delivering tangible impact to investors, we have recently launched a successor fund, the Mergence's Infrastructure & Development Equity Fund II which is open to new commitments from institutional investors.

We offer a number of infrastructure-focused funds to our pension fund clients which all fall under the definition and allocations provided by the update to Regulation 28.

For convenience, we summarise these funds and under which regulatory limits they would fall.

Fund	Private Equity	Private Debt	Listed Debt	Infrastructure
Mergence Infrastructure & Development | Equity Fund II	100%			100%
Mergence Renewable Energy Debt Fund I		100%		100%
Mergence Renewable Energy Debt Fund II		100%		100%
Mergence Infrastructure & Development | Bond Composite Fund		40%	60%	40%

CLICK *on fund names above for further information.*

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