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Regulation 28: Protection in action

Enron and Steinhoff both collapsed due to excessive greed, deceitful earnings and fraudulent accounting practices. In both cases many jobs were lost, and many investors lost massive amounts of money. There was however one big difference in the losses experienced by members in retirement funds. Enron employees also lost a significant share of their retirement savings while Steinhoff's employees' retirement funds were protected from huge losses.

The reason for the huge losses on the part of Enron employees is because a significant amount of their retirement fund assets in their 401 (K) plan was invested in Enron equities. In the USA retirement funds are known as 401(k) plans.

The protection offered to Steinhoff employee's retirement savings.

While South Africa is seen as a third world country, the governance around the protection of members retirement savings is nothing but first world. In fact, our legislation and controls offer highly developed means of protection to members in retirement funds on many levels. In this article we focus on the protective measures as it relates to members' invested fund credits.

The loss which the Enron employees suffered could never happen in South Africa due to our Pension Funds Act 24 of 1956. In South Africa, Regulation 28 of the Pension Funds Act sets out the investment limits and guidelines for retirement funds, such as pension funds and retirement annuity funds. These regulations dictate how much of a fund's assets can be invested in various asset classes such as equities, property, and foreign investments. There are also limits applied within each of the asset classes. The aim is to ensure prudential investment practices and manage risk for retirement savings.

Investment managers must submit quarterly compliance reports and on an annual basis to the Financial Sector Conduct Authority (FSCA). These reporting measures ensure that the limitations of Regulation 28 are not exceeded. In a nutshell, Regulation 28 ensures that you are invested in diversified types of assets so that you don't take unnecessary investment risks by having most of your assets invested in any one asset class.

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In terms of Regulation 28, no more than 75% of the retirement fund's assets can be invested in equities. Within the equity class no more than 15% can be invested in any one listed entity with a market capitalisation of more than R20 billion. This maximum threshold prevents overexposure to any one listed equity, thereby limiting the losses should the value of any equity holding suddenly crash.

As a result of Regulation 28's limits, retirement funds in South Africa held between 8% and 10% in their investment portfolios in Steinhoff and the loss was limited when the value of shares crashed in 2017.

Enron employees were not protected in this way, and up to 61% of Enron's shares were invested in their retirement fund. When the Enron scandal surfaced and share prices crashed in 2001, not only did Enron employees lose their jobs but they also lost a significant amount of their future retirement savings. This loss was so significant that employees, especially those close to retirement, would never be able to recoup their retirement savings.

The Enron scandal prompted significant changes and reforms in the USA in the regulation and oversight of 401(k) plans to protect employees' retirement savings. As a result, several reforms and regulations were introduced to improve transparency, diversification, and oversight.

However, even with these changes the regulations around the 401(k) plans are still lagging the prudent guidelines adopted in Regulation 28 in protecting employee's savings.

Please visit our website for more information at www.phoenixfin.co.za
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