

Fund Members Pay the Price for Laws

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Business Report



Warren Brown

Johannesburg - The use of regular market benchmarks and obsolete legislation was costing pension fund members additional returns on funds, asset managers said last week.

Warren Brown, the head of fixed interest and financial modelling at Symmetry, said research had shown that many benchmarks used to develop pension fund investment strategies, such as the JSE all share index, were structurally flawed.

These benchmarks did not include all the shares tradeable in the respective markets.

The tendency was for the indices to overweight overvalued shares and underweight undervalued shares, resulting in inferior returns. There was a need for alternative portfolio construction models.

Brown said the current pension fund legislation compounded the problem by restricting pension funds access to diversification.

The Pension Funds Act limits the investment that pension funds can make into unlisted entities, such as hedge funds, to 2.5 percent of assets.

Brown argued that these constraints resulted in pension funds foregoing returns and taking more risk than they would if there was flexibility.

Mothobi Seseli, the managing director at Argon Asset Management, said the trend in the past was to follow what had been the norm.

He added that managers could deliver better returns if strategies were driven by opportunities. Benchmarks were only important insofar as they helped a comparative analysis of performance. Focusing on benchmarks distracted managers from opportunities to help increase returns.

Sandile Mbili, the head of retirement fund consulting at Lekana Employee Benefit Solutions, said pension fund regulation had a fairly conservative philosophy. Pension funds would be able to yield better returns if exposure to different asset classes was increased.

Managers had resorted to the herd mentality because of the restrictive nature of the legislation.

Mbili argued that the draft pension fund reform paper provided for no restrictions on investments.

But the flexibility that it would bring would require trustees to ensure that investment strategies were reviewed regularly. This would place more responsibility on trustees. Fund managers and advisers would have to educate trustees in the new legislation.

The chief investment officer at Futuregrowth Asset Management, Alberto Bottega, said the balance between risk and return had always preoccupied the pension fund industry.

He said asset classes that were essential for creating new wealth were aligned with two contrasting objectives: limiting risks and optimising returns. While trustees were ultimately responsible, unconstrained investment would not be considered prudent.

But Brown argued that the obsession with limiting risk could destroy much of the value that an investment manager was able to add.

Anne Cabot-Alletzhauer, the chief investment officer at Advantage Asset Managers, said legislation did not account for the progress that had been made in the development of new and viable asset classes, which would create additional returns at lower risk levels.