



Botswana Pensions Society 2019 Annual Conference

Cresta Maun Hotel, 25-26th February 2019

Topic; Update on the revised Pension Prudential Investment Rule (PFR 2).

Prof Emmanuel Botlhale, University of Botswana

Objectives of the presentation

- The overarching objective of the presentation is to;
 - 1. To give the pension industry an update on developments on the revised Pension Prudential Investment Rule (PFR 2).
- ▶ Secondly, the presentation aims to;
 - 1. To discuss opportunities and challenges of the revised PFR 2; and
 - 2. To solicit input [ideas] from the pension industry on the way forward regarding future engagements with the regulator on PFR 2.

Main Arguments

1. That pension regulation and supervision are key to safeguard life savings of members.
2. That pension regulation and supervision play a key role in ensuring prudent pension regulation and supervision.
3. That given increasingly knowing and assertive members, pension regulation and supervision are no longer a 'tick-the-box' undertaking.
4. That PFR 2 must be understood and appreciated under the rubric of efficient and prudent pension regulation and supervision.
5. That PFR 2 is a living document that, inevitably, has teething and/or operational problems, so, the need for the pension to continually engage the regulator on the same.

Outline of the presentation

1. Pension regulation and supervision; and PFR 2.
2. Pension Regulation & Prudential Rules.
3. Brief recap on Circular No. 2 of 2015.
4. Initial concerns on PFR 2.
5. Revised PFR 2; key requirements.
6. Transitional Arrangements.
7. PFR 2 (contents).
8. Pension Regulation via PFR 2.
9. Concerns raised by the industry on PFR 2.
10. PFR2 Working Committee.
11. Revisions/amendments on PFR 2.
12. Appreciation 4 Revisions/amendments on PFR 2.
13. Conclusion & way fwd.

Pension regulation and supervision; and PFR 2

- It is vital to note that there is a distinction between pension regulation and supervision.
- Regulation: legal foundations and system of rules and regulations governing the structure and operation of pension funds.
 - Regulations establish form of system and “empower” various parties to perform functions or protect interests.
- Supervision: oversight and enforcement of compliance with the rules- collection of information and monitoring of system to support review and analysis (Richard *Hinz*, 2014; Regulation and Supervision of Pension Funds).
- PFR 2, as a tool, operates at the level of regulation and its enforcement operates at the level of supervision [the two complement each other].

Pension Regulation & Prudential Rules

- Section 50 of the NBFIRA Act empowers The Regulatory Authority to make and publish rules that prove to be a significant contributor in preventing or minimising financial sector risks.
- 1. PFR1_Funding Valuation Rules.
- 2. **PFR2_Fund Investment Rules.**
- 3. PFR6_Fund Actuarial Triennial Report.
- 4. PFR7_Conditions For Exemption from Actuarial Valuation.
- 5. PFR8_Suitability of Investments-Pensions.
- 6. PFR10_Conduct Expected of Board of Trustees.
- 7. New License Application -Pension or Provident Fund (PFA1).
- 8. New License Application- Fund Administration (PFA2).
- 9. New License Application- Fund Custodian (PFA3).
- 10. Funding Valuation Rules (PFR1).
- 11. Fund Investment Rules (PFR2).
- 12. Fund Administrators Return (PFR5).
- 13. Fund Actuarial Triennial Report (PFR6).
- 14. Conditions for Exemption from Actuarial Valuation (PFR7).

Brief recap on Circular No. 2 of 2015

- The Non-Bank Financial Institutions Regulatory Authority issued Circular No. 2 of 2015 in which the industry was informed to comply with requirements of the revised Pension Prudential Investment Rule (PFR 2).
- Addresses: Pension & Provident Funds; Asset Managers; Asset Consultants; Fund Administrators; BPS.
- ▶ Issue Date: 5 October 2015.
- ▶ Effective Date: 1 November 2015.
- ▶ Subject: revised Pension Investment Rule (PFR 2); appointment of Risk Mgt Committee; and transitional arrangements for Pension Prudential Rules.
- ❖ PFR 2 was promulgated in terms of sec 50 of the NBFIRA Regulatory Act.

Initial concerns on PFR 2

- ▶ Pursuant to concerns by the industry on limits imposed in terms of circular 1 of 2013, NBFIRA resolved to suspend PFR 2 pending extensive & full consultations with the industry.
- ▶ A working committee was made up of reps from Fund Administrators, Asset Managers & Trustees of various Pension Funds to review PFR 2 with NBFIRA.
- ▶ In addition, then MFDP was involved in working committee meetings.
- ▶ The 1st working committee meeting was held on 12/12/14; and 2nd meeting was held on 16/12/14.
- ▶ In the subsequent, the revised PFR 2, with input from the industry, was tabled to the NBFIRA Board for final approval.

Revised PFR 2; key requirements

- ▶ Subsequent to the consultative process, NBFIRA issued PFR 2 which superseded Circular 1 of 2013.
- ▶ NB, the revised PFR 2 provided the retirement fund industry with the revised quantitative limits on assets to be held by a retirement fund.
- ▶ In addition, every retirement fund must:
 1. Establish a Risk Committee.
 2. Appoint a Risk Officer who should be a member of the Risk Committee.
 3. Formulate an Investment Policy.

Transitional Arrangements

- ▶ The effective date was 01/11/2015.
- ▶ However, in terms of sec 6 of the revised PFR 2, retirement funds had a transitional period of 6 months to review and ensure compliance with the quantitative limits as per sec 7 of PFR 2.
- ▶ NBFIRA expected compliance with quantitative limits & other requirements set out in PRF 2 by no later than 30 April 2016.

PFR 2 (contents)

1 *Introduction*

- 1.1. Definitions

2. *Investment Policy*

- 2.5 Certification by the Actuary
- 2.4 Communication with Members
- 2.5 Individual member choice
- 2.6 Returns

3. *Valuation of Assets*

- 3.1 Valuation Methodology
- 3.2 Disallowed Assets
- 3.3 Derivatives
- 3.4 Limits on Asset Classes
- 3.5 Limitation on Foreign Investment

5. *Risk Management*

Regulatory Authority's Exemption

6. *Transitional Arrangements*

- Time limit to comply

7 *Investment Restriction per Asset Class*

Pension Regulation via PFR 2

Prior to PFR2, pension fund investments were managed to comply with one foreign exchange exposure requirement determined by then Ministry of Finance and Development Planning (MFDP).

Pension funds were required to invest a minimum of 30% of their assets in domestic securities (it was commonly known as the “30/70 rule”).

Other than this requirement, pension fund investments were self-regulated by the trustees with the assistance of professional advisers since the establishment of the first private occupational pension funds in the 1980s.

Concerns raised by the industry:

- The reversal of the 30/70 rule to a minimum 70% domestic investment requirement without due consideration of the local market conditions.
- The most significant constraint was the constrained liquidity of the Botswana Stock Exchange, limited opportunities in the Botswana government bond and over-the-counter securities markets.
- The infeasible request for NBFIRA to pre-approve securities/issuers and individual country exposures.
- Adopting a conservative asset allocation (maximum 60% equity exposure) for a young working population with an above average risk profile.
- The unclear desire to align pension fund investment limits with the South African policy framework despite Botswana's exclusion from the (Rand) Common Monetary Union and other structural differences between the two polities.

PFR2 Working Committee

- NBFIRA was a willing participant in the consultation process that resulted in the formation of the PFR2 Working Committee in the early part of 2014.
- The Working Committee was established with a majority representation from the pension funds to ensure that trustees represented members' interests directly to NFIRA. These are:
 1. Prof Emmanuel Botlhale; Chair of PFR2 Working Committee; Chair, University of Botswana Defined Contribution Pension Fund.
 2. Tapologo Motshubi; Member of PFR2 Working Committee; Portfolio Manager, Allan Gray Botswana.
 3. Lesego Ntebela; Member of PFR2 Working Committee; Botswana Life Insurance Limited Pension Fund.
 4. Moemedi Malindah; Member of PFR2 Working Committee; Botswana Public Officers Pension Fund.
 5. Peter Hikhwa; Member of PFR2 Working Committee; Deputy Director-Pension Consulting, AON Botswana.

The five members of the Working Committee consisted of three pension fund trustees, one asset manager and one employee benefit or asset consulting representative.

After extensive negotiations, PFR2 finally came into effect on 1 November 2015 with a six-month transition period.

The PFR2 Working Committee continued to lobby for additional changes, particularly, with regard to the maximum foreign cash and cash equivalents instrument limit which had been erroneously overlooked in prior versions.

Revisions/amendments on PFR 2

- Commendably, NBFIRA undertook to review PFR2 on an annual basis, culminating in the current version being effected on 1 December 2017.
- Whilst this version addressed a majority of the issues in the 2015 version, it introduced a 5% issuer limit across the portfolio that had not been discussed with pension funds or the PFR2 Working Committee.
- Whilst there are ongoing processes to request exemptions for affected pension funds, increases as regards this limit per asset class are necessary to enable the effective portfolio management of member portfolios.

Appreciation 4 revisions/amendments on PFR 2

- PFR2 Working Committee plentifully thanks NBFIRA for enabling the dialogue and contributing to the continued success and stability of Botswana's capital markets.
- In a related vein, it abundantly thanks the pension industry for continuing to repose its confidence in it as it lobbies and advocates on matters of common interest to the pension industry.

Conclusion & way fwd

- Conclusion;

- PFR 2, like any other policy document, has teething and/or problems.
- There4, the challenge is to trouble-shoot PFR 2 for teething and/or operational problems.
- SWOT analysis will enable the industry to maximize PFR 2.

- Way fwd;

- In this regard, and subject to sanction by the pension industry, the PFR 2 Working Committee intends to request a meeting with NBFIRA to formally request the latter to consider request for exemptions for affected pension funds and increases as regards per asset class.
- In addition, it will present any issues that the industry will mandate of the committee so as to enhance fund governance.