BIZCOMMUNITY

Using prescribed assets to get out of a financial fix

By Janina Slawski,

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The debate around the prospect of prescribing private and public pension fund money to bail out Eskom, and other financially impaired state-owned enterprises, continues.

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While the ideal of fully-functioning Eskom is one we all aspire to, implementing a version of prescribed assets implemented during the 1950s to 1970s is not the ideal solution and is cause for concern.

There have already been other stakeholders who have mooted the suggestion that the Public Investment Corporation (PIC) should have its investors – the most significant of which is the Government Employees Pension Fund (GEPF) – take on R250bn of Eskom's debt.

How have prescribed assets worked out in the past?

To understand the principle of using prescribed assets as a means of getting out of a financial fix, we need to take a step back in time. Who were the winners and the losers in the past? Historical numbers show why we should question the value of a prescribed asset approach.

Equity holders gained, bondholders lost out

In the previous period of prescribed assets there were significant gains, which ironically led to the establishment of state-owed entities such as Eskom and Sasol. However, these gains accrued to the equity holders of these entities: the government of the day. The bondholders received a poor return on investment (ROI) when they were forced through prescription to invest in the bonds that funded and founded these institutions.

- **1960s**

  Inflation averaged 3.0%. Although prescribed assets earned positive real returns, they earned -6.4% a year less compared with equities over the decade.

- **1970s**

Inflation averaged 11.3%. Prescribed assets earned 7.3%, while equities returned 24.5%. Therefore the opportunity cost of investing in prescribed assets compared with equities was -17.2% a year.

- ### 1980s

  Inflation averaged 14.5%. The opportunity cost of investing in prescribed assets compared with equities was -6.7% a year.

Employers, not fund members, were affected in defined benefit funds

Prescription affected defined benefit funds mainly over this period. This meant that employers who paid the balance of cost of these funds suffered the loss of ROI rather than fund members.

Fund members, not employers, would be affected in defined contribution funds

If we had to reinstate prescription, which ceased in 1989, the opposite would be true now.

The winners and losers would switch chairs: employees of what are now mainly defined contribution funds would take the knock as bondholders. Employers would not be affected by suffering the opportunity cost of prescribed assets.

Equity holders would gain, bondholders would lose

It would still be the equity holders, if any, who would benefit from a ‘revitalised, revamped, non-corrupt’ Eskom. However, the bondholders would suffer from:

- poorer bond returns since these are not based on purely commercial terms, and
- the loss of opportunity to invest in other assets that better meet their risk and return objectives

This major shift from winners to losers results from the fact that most retirement funds are now defined contribution funds. A change from defined benefit to defined contribution means that it’s the members of the funds who will suffer. Simply put, every member of a defined contribution fund that produces poorer returns due to prescription will retire, or leave their funds, with less money than they would have in the absence of prescription.

In respect of the GEPF, taxpayers will suffer

There are still several large defined benefit funds in South Africa, specifically the GEPF. In this instance it is the employer who will still suffer from the poorer investment returns. However, since the employer in this instance is the government, which means that ultimately it is the taxpayers who will suffer through higher contributions, funded from tax revenues, that will need to be paid into the GEPF.

For this reason, we do not support any imposition of prescription that prevents investors from investing in assets that meet their risk and return profiles. If investors are being forced to invest in assets through prescription, the investments will give suboptimal investment outcomes that will not be in the interests of investors:

- Members of defined contribution retirement funds, in particular, who rely on investment returns to build up their retirement savings
- Pensioners who rely on investment returns to support their pension increases

We are extremely supportive of efforts to drive the voluntary mobilisation of funds to support developmental objectives. What we would not support is the concept of this investment being forced through prescription because of a risk of a loss of ROI for individuals who rely on the value of their retirement fund as their main form of life savings.

ABOUT THE AUTHOR

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