South African Reserve Bank

Financial Surveillance Department

2010-12-14

Exchange Control Circular No. 44/2010

Revised prudential limits for Institutional Investors

Authorised Dealers are referred to the 2010 Budget and the Medium Term Budget Policy Statement as well as the press release issued by the National Treasury on 2010-12-13, a copy of which is attached for ease of reference, concerning the revised prudential limits.

A further Circular, in amplification of the aforegoing, has also been issued today.

Deputy General Manager

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national treasury
Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Press Release: New prudential limits and discussion document

Introduction

In the 2010 Budget and the Medium Term Budget Policy Statement, the Minister of Finance said that details of proposed changes to financial and foreign exchange regulatory arrangements would be published before the end of this year. These proposed changes include:

- **Regulation 28**. The second draft of Regulation 28 was released on 10 December 2010. Linked to this draft, today the prudential foreign asset limits for institutional investors are also being revised.
- **Discussion document**. To allow for more time for internal consultations within government, the release of the comprehensive discussion document entitled *Strengthening the financial sector to better serve South Africa* is postponed and will now be released for public comment in February next year.

Background

Drawing on the lessons learnt from the global financial crisis, Government has previously announced reforms to improve the capacity of South Africa to better manage flows of capital, and to complement the current system with a macro-prudential approach to the regulation of foreign exposure. A broader, long-term emphasis on prudential financial supervision was indicated as early as 1997, while reforms aimed at shifting towards prudential regulation for institutional investors were announced in the 2004/2004 Budget. In terms of this approach, a number of announcements were made in the 2010/2011 Budget and in the 2010 Medium Term Budget Policy Statement..

The prudential approach to regulating foreign exposure aims to manage and encourage two-way flows of capital, whilst allowing a small, open economy such as South Africa, to respond to external shocks with appropriate policy instruments. In addition, a gradual and sequenced liberalisation of exchange controls also protects the economy against large outflows of domestic capital and an increased reliance on volatile foreign capital. The country's approach to reform therefore takes cognisance of the need to find the right balance between supporting outward investment and cushioning the economy against shocks.

In the 2008 Budget, the Minister announced the replacement of exchange controls on institutional investors with prudential regulation. This was a major announcement since it removed the inefficient exchange control application and approval process on institutional investors' offshore investments.

In the 2010 MTBPS, the Minister announced that "the prudential framework for foreign investment by private and public pension funds, including the Government Employees Pension Fund will be reviewed to support portfolio re-alignment and offshore diversification of these funds, especially in the rest of the African continent and into other emerging markets".

Current analysis shows that a number of institutions, in particular retirement funds, representing a significant portion of the industry investable assets, could be constrained by the current prudential foreign asset limit, especially if GEPF is excluded in the analysis.

As part of a package of measures to respond to surging portfolio inflows and to concretise the announcements made by the Minister in the 2010 MTBPS, National Treasury announces a 5 percentage point increase in the limit to the percentage amount that institutional investors can invest offshore.

New revised limits:

	2008	**2010**
Retirement Funds	20%	25%
Collective Investment Schemes	30%	35%
Investment Managers	30%	35%
Long-term Insurers (Investment-linked)	30%	35%
Long-term Insurers (Non-investment linked)	20%	25%

National Treasury would like to alert investors that the announced increase in prudential foreign asset limits should also be regarded as a mechanism for absorbing current holdings of inward listed instruments not having a domestic classification. Specifically, this includes those inward listed shares which have been granted an extension or exception by the Minister to allow for their holding outside the foreign investment limits for a transition period that will expire in the next two years. It is the Treasury's view that the 5 per cent increase in the foreign prudential limit should be sufficient to incorporate such existing holdings.

The Reserve Bank will provide further details on these announcements.

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