

# News and views on emerging markets:

## **SOUTH AFRICA: TOUGH TALK ON HEDGE FUNDS**

After American and European hedge funds were battered by the financial crisis, regulators quickly targeted them for a new wave of regulation. Their South African counterparts got off reasonably lightly - no hedge fund has collapsed in the country for five years, and the industry's assets under management fell by a modest 2 per cent in the year to June 2009. The figure grew by 8 per cent the following year - but that hasn't stopped South African authorities from vowing to tighten restrictions on the funds.

While hedge fund managers are carefully vetted before receiving a licence, the products they administer are not regulated - a situation that Pravin Gordhan, finance minister, vowed to end in his budget speech in February, and again in his medium-term budget statement last week.

On Tuesday, Patrick Ward of the Financial Services Board tried to soothe any worries about overbearing regulation, saying: "I don't think our intention is to cause a flight of hedge funds out of the country because the regulation is too tight ... It's a balance we are seeking to achieve."

But industry players are less concerned about the strictness of the new rules, than about the time it is taking to put them in place. The drive to regulate hedge fund products may have been given urgency by the crisis, but it has been on the agenda for the last six years, says Robert Foster, chief operating officer of Alpha Asset Management.

"We are at that stage where there's a requirement for clarity from policymakers and regulators, to give new levels of confidence to invest," he says.

While speculative inflows into the South African bond market topped R70bn in the first nine months of this year, only about 2 per cent of hedge fund capital is from overseas, Foster estimates. Provided it is not heavy-handed, he says, the new regulations should open the door to more interest from foreign investors.

But as long as the possibility of restrictive regulation hangs over the industry, many investors will hold off from pumping capital into hedge funds. Key among these are the domestic pension funds, which have some R2,000bn (\$294bn) under management. "A lot of trustees of retirement funds are uncomfortable with investing in unregulated products," says Fatima Vawda, managing director of the 27Four fund of hedge funds.

More adventurous types in the industry are keen to invest in hedge funds, however - but are held back by a decree that they may invest no more than 2.5 per cent of their portfolios in "alternative investments". But fund managers are keenly waiting for the results of a review of the Pension Funds Act, which is widely expected to raise that limit - perhaps as high as 15 per cent, says Thomas Schlebusch, chief investment officer of Blue Ink Investments.

"The current limit is so low that a lot of people don't want to waste their time on managing 2.5 per cent of their portfolio," he says - meaning that a higher bar could herald a surge of new investment into hedge funds.

Yet the industry is still a small fish in the South African financial sector. The first domestic hedge funds appeared only in the late 1990s and assets under management are still only R32bn, despite rapid growth over most of the last decade. This helps to explain the delay in drafting regulation, Vawda says. "Hedge funds are tiny if you look at a R2,000 billion long-only market. [The regulators] have got other priorities they need to deal with."

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