

Side pockets may be a headache for deceased estates and retirement funds

On August 15, the registrar of collective investment schemes at the Financial Services Board (FSB) issued a guidance note that set out how managers of collective investment schemes can create a retention fund (side pocket) to segregate illiquid African Bank assets.

The creation of side pockets affected investors in money market unit trust funds that had invested in African Bank debt. By August 26, the FSB had approved 50 side pockets for money market funds, with a market value of about R4.6 billion.

Side-pocketing may have implications for the winding up of deceased estates and for retirement fund members who leave their funds.

◆ **Deceased estates.** The extent to which side-pocketing may affect the finalisation of deceased estates will depend on whether or not assets that have been

side-pocketed have to be sold to provide liquidity in the estate, says Alfie Bester, a member of the Fiduciary Institute of Southern Africa and a fiduciary specialist at Legacy Fiduciary Services & Estate Planning. Where assets have to be sold, their illiquidity may result in a delay in the winding up of the estate. Bester says heirs could elect to take transfer of the affected financial instruments and pay their own cash into the estate to enable it to be wound up.

Where the affected debt instruments do not have to be sold to provide liquidity, he says, the assets can be reflected in the executor's liquidation and distribution account as being awarded to the beneficiaries at the value as at the date of death. The instruments can then be transferred to the beneficiaries, who may sell them at a later date. The transfer will enable the executor to finalise the

administration of the estate, Bester says.

◆ **Retirement funds.** Alta Marais, the head of pensions research and policy at the FSB, says the FSB is conducting a survey of retirement funds to establish:

□ Fund investments in African Bank on August 1 and again on August 31, to determine the impact of the curatorship;

□ The entities through which funds accessed African Bank investments – that is, direct investments, collective investment schemes, life insurers or investment managers; and

□ Practical difficulties experienced by funds in paying benefits where a portion of the assets backing the benefits forms part of a side pocket.

Marais says that once the FSB has gathered the information, the registrar of pensions will consult other registrars and regulators to try to resolve any problems.

WHAT IS SIDE-POCKETING?

Side-pocketing is the separation of illiquid assets from more liquid assets, by transferring the illiquid assets to a separate portfolio, called a retention fund, or side pocket. (An illiquid asset either cannot be traded or cannot be converted into cash without losing a significant percentage, or all, of its value.)

Portfolio managers transferred each investor's share of the fund's exposure to African Bank's fixed-interest instruments to a retention fund. The value of African Bank's shares had dropped to zero; therefore, side pockets were not created for equity holdings.

Investors' money in the retention funds has not been written-off; it has been ring-fenced. The money in the main funds continues to trade, receive contributions, pay out withdrawals and earn interest.

UNDER WHAT CONDITIONS WERE SIDE POCKETS CREATED?

The main conditions required by the FSB are that the asset manager:

◆ Must clearly describe the assets to be placed in the retention fund;

◆ Must confirm that the retention fund is closed ended (restricted to investors in the main portfolio when the side pocket was created);

◆ Will ensure the "fair" valuation of the assets in the retention fund;

◆ Will ensure that the assets are realised as soon as they become liquid;

◆ Must state what will happen to the assets in the retention fund if they cannot be realised or traded;

◆ Must describe the fees and charges in respect of the retention fund; and

◆ Must regularly report to you about the status of side pockets and related assets.