



Financial Sector
Conduct Authority

Performance of South African Retirement Funds: Challenges, Opportunities and Key Trends

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REGULATION 28: ASSET SPREADING REQUIREMENTS

- The importance of diversification in mitigating risk when investing in retirement funds finds expression in Regulation 28 to the Pension Funds Act, 24 of 1956.
- First promulgated in 1962, it was substantially amended with effect from 1 July 2011.
 - It is considered rigorous, flexible and fair, attempting to promote transparency in areas where rules have traditionally been circumvented but also allowing for some level of innovative financial strategies and instruments where appropriate.
 - The preamble of Regulation 28 provides as follows:

“A fund has a fiduciary duty to act in the best interest of its members whose benefits depend on the responsible management of fund assets. This duty supports the adoption of a responsible investment approach to deploying capital into markets that will earn adequate risk adjusted returns suitable for the fund’s specific member profile, liquidity needs and liabilities. Prudent investing should give appropriate consideration to any factor which may materially affect the sustainable long-term performance of a fund’s assets, including factors of an environmental, social and governance character. This concept applies across all assets and categories of assets and should promote the interests of a fund in a stable and transparent environment.”

REGULATION 28: ASSET SPREADING REQUIREMENTS

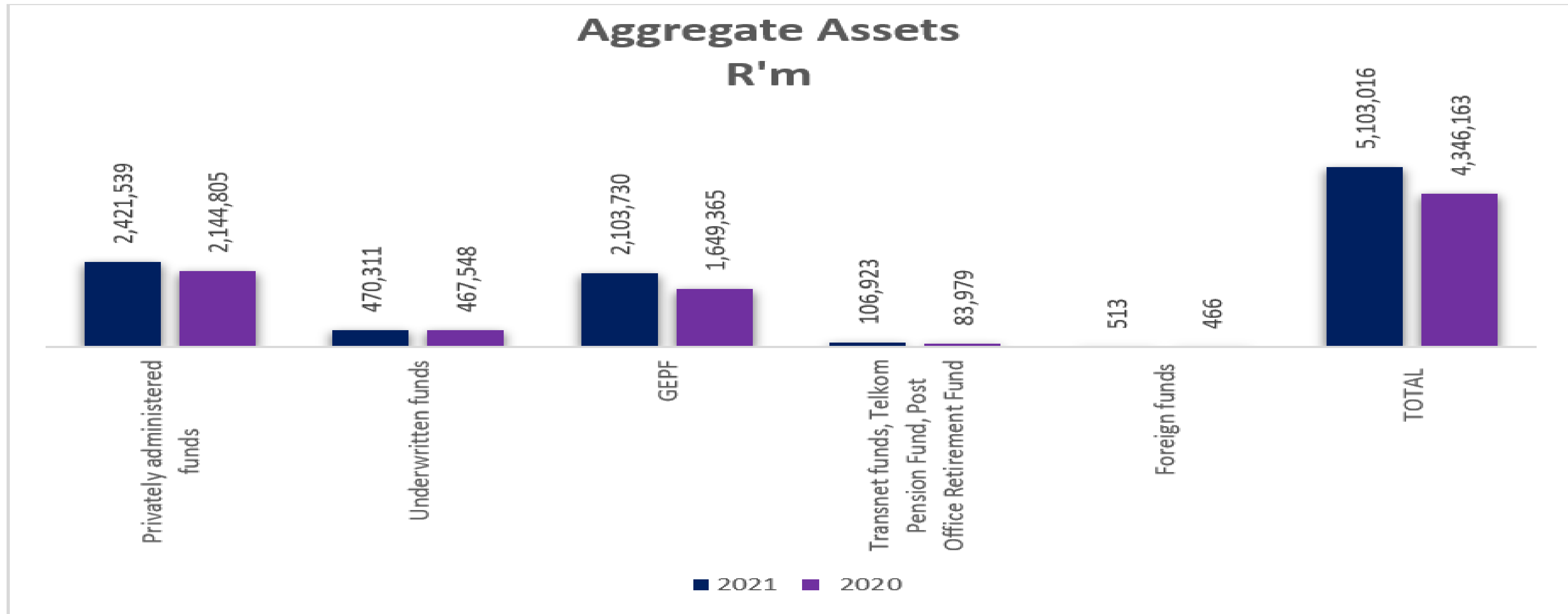
- Regulation 28(3)(a) provides that all retirement funds must only hold assets and categories of assets in compliance with the limits set out in Regulation 28. Below is a summary of the overall limits per asset class iro 2022 amendments.

Categories of assets	The maximum percentage of the aggregate fair value of total assets of the fund.
Cash	100%
Debt instruments including Islamic debt instruments.	100% if issued or guaranteed by the Republic of South Africa, otherwise 75%
Equities	75%
Immovable property	25%
Commodities	10%
Investments in the business of a participating employer inside the Republic of South Africa in terms of section 19(4) of the Pension Funds Act	5%
Housing loans granted to members in accordance with the provisions of section 19(5) of the Pension Funds Act	65%
Hedge funds	10%
Private equity funds	15%
Other assets not referred to in this schedule	2.5%

REGULATION 28: ASSET SPREADING REQUIREMENTS

- A retirement fund may only invest in assets specified in Regulation 28 and within the issuer and aggregate limits defined. Provision is however made for involuntary breaches that fall beyond the control of the Board of the fund (for example market movements or corporate actions).
- Amendments to Regulation 28 were published on 1 July 2022 and came into effect on 3 January 2023. These amendments introduced a definition of infrastructure and set a limit of 45% for exposure in infrastructure investment. To further facilitate the investment in infrastructure and sustainable economic development, the limit between hedge funds and private equity were split. There is a separate and higher allocation to private equity assets, which is now 15%.
- Retirement funds will continue to be prohibited from investing in crypto assets. The excessive volatility and unregulated nature of crypto assets require a prudent approach.
- The asset allocation to housing loans granted to retirement fund members was reduced from 95% to 65%.
- A limit of 25% has been imposed, across all asset classes to limit exposure of retirement funds to any one entity (company). However, one exception to the per entity limit, is debt instruments issued by, and loans to, the Government of the RSA and any debt or loan guaranteed by the RSA.

PERFORMANCE OF RETIREMENT FUNDS (ROI)



Retirement funds industry assets increased by 17.4%, from R4.3 trillion in 2020 to R5.1 trillion in 2021. The net assets of privately administered funds increased by 12.9% from R2.1 trillion in 2020 to R2.4 trillion in 2021.

PERFORMANCE OF RETIREMENT FUNDS (ROI)

- The return made by pension funds on the value of investments is calculated using the following formula:

$$R = \frac{2i}{A+B-i}$$

Where

A

B

i

=

=

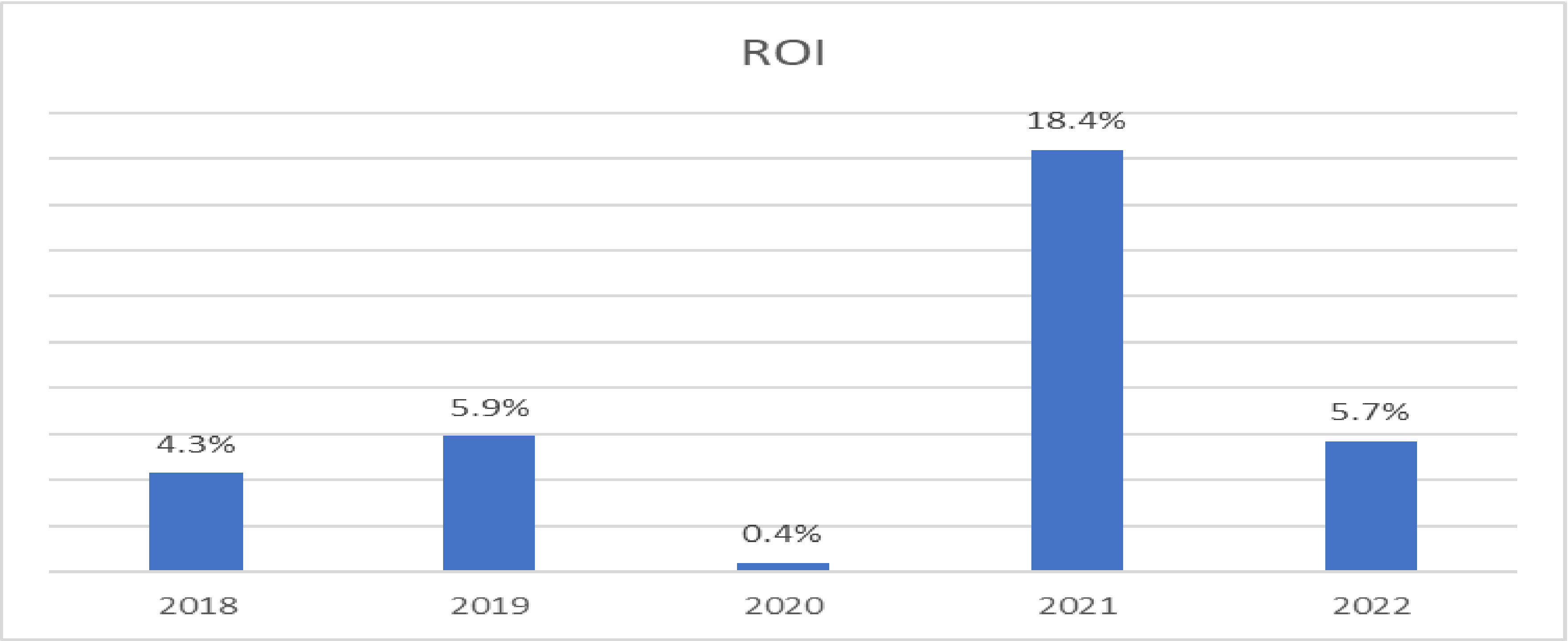
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Return on investments

Initial value of investments

End value of investments

Interest, dividends, rent, policy income, net profit or losses on realisation of investments and the amount by which investments were written up or down to fair value. Funds are required to disclose in their financial returns the method used for determining accrued, vested or provisional income from insurance policies. Non-vested policy income is included in or excluded from the revenue account at the discretion of funds.

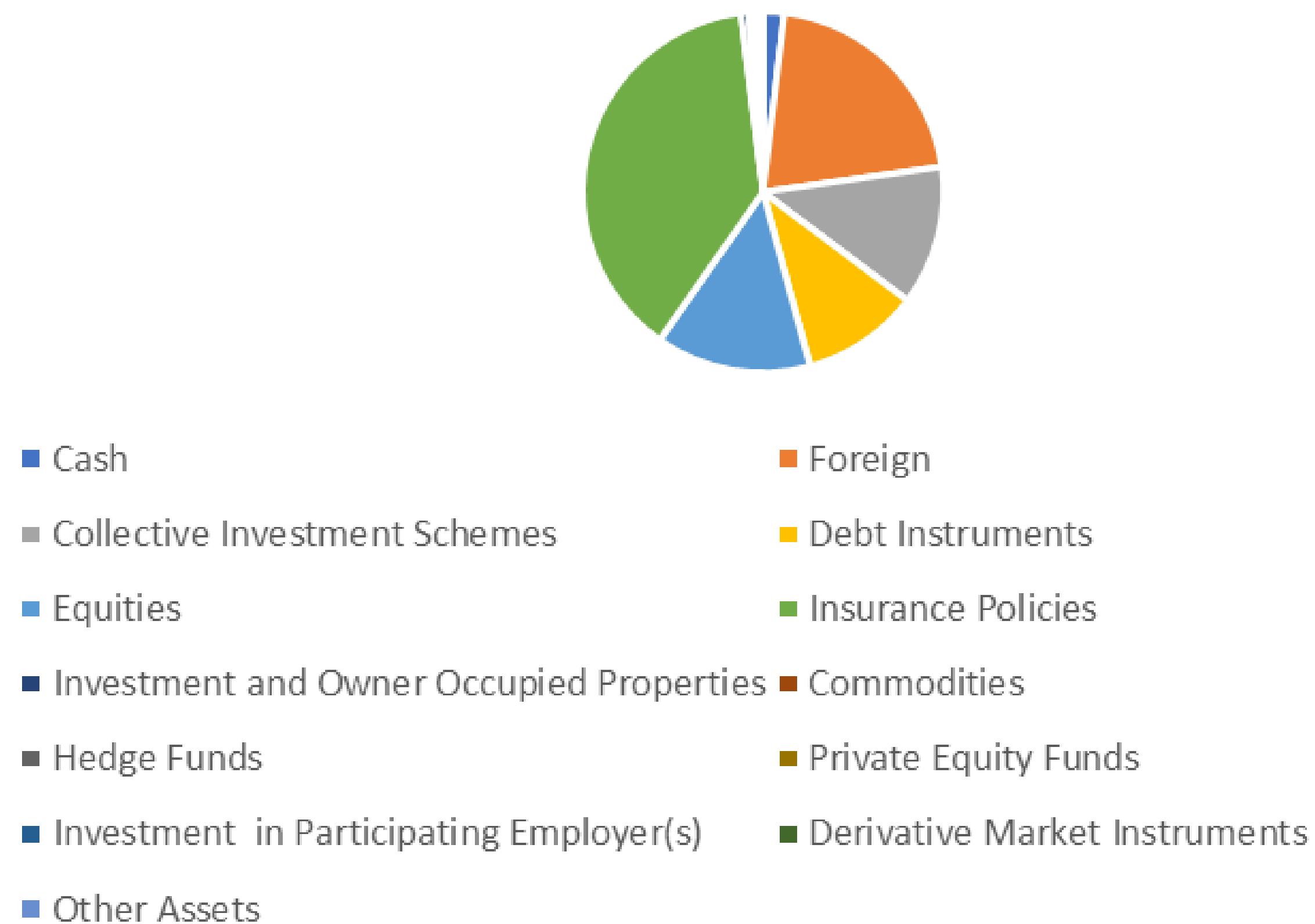


Year	Average Annual Consumer Price Inflation*
2018	4,7%
2019	4,1%
2020	3,3%
2021	4,5%
2022	7,2%

* https://www.statssa.gov.za/?page_id=1859

PERFORMANCE OF RETIREMENT FUNDS (ROI)

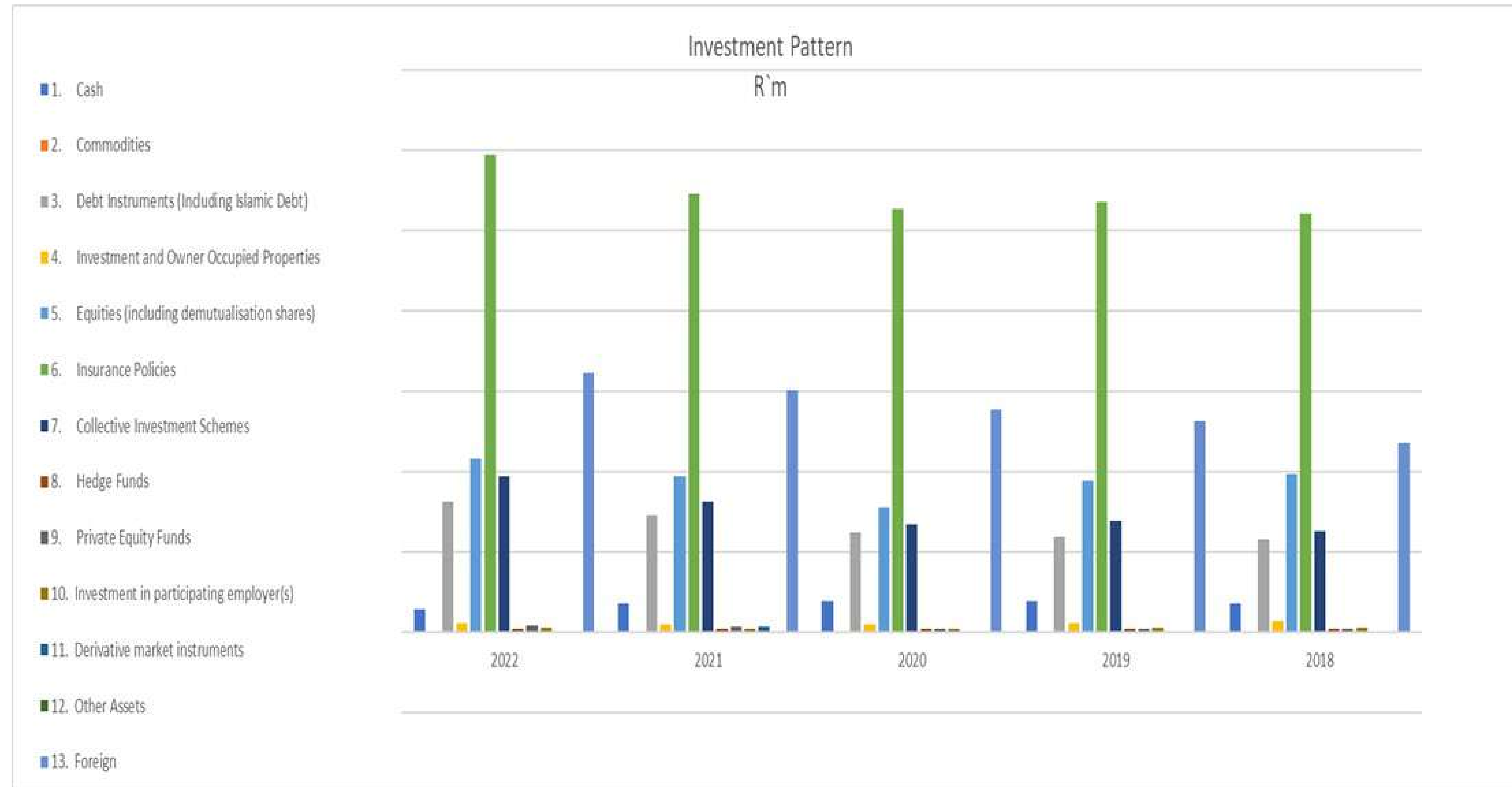
South African Retirement Funds Asset Allocation 2022 (%)



PERFORMANCE OF RETIREMENT FUNDS (ROI)

South African Retirement Funds Asset Allocation	2022	2021	2020	2019	2018
	R'm	R'm	R'm	R'm	R'm
1. Cash	58,734	70,883	77,380	77,770	71,303
2. Commodities	2,209	2,741	4,026	3,548	2,937
3. Debt Instruments (Including Islamic Debt)	326,879	290,262	249,746	238,343	232,957
4. Investment and Owner Occupied Properties	22,039	19,895	18,997	24,323	27,314
5. Equities (including demutualisation shares)	431,481	388,171	311,015	376,245	393,527
6. Insurance Policies	1,187,816	1,091,966	1,055,222	1,071,752	1,043,299
7. Collective Investment Schemes	387,662	326,077	268,425	276,754	252,177
8. Hedge Funds	8,676	8,936	7,399	8,336	9,594
9. Private Equity Funds	15,950	15,334	8,912	7,610	7,404
10. Investment in participating employer(s)	11,328	9,739	8,912	11,485	10,626
11. Derivative market instruments	864	13,284	-	771	(76)
12. Other Assets	458	561	951	852	765
13. Foreign	647,055	602,202	554,510	524,662	472,004
Total	3,101,152	2,840,051	2,565,495	2,622,451	2 533 831

PERFORMANCE OF RETIREMENT FUNDS (ROI)



PERFORMANCE OF RETIREMENT FUNDS (ROI)

South African Retirement Funds Asset Allocation	2022	2021	2020	2019	2018
	%	%	%	%	%
1. Cash	1.89	2.5	3.02	2.97	2.83
2. Commodities	0.07	0.1	0.16	0.14	0.12
3. Debt Instruments (Including Islamic Debt)	10.54	10.22	9.73	9.09	9.23
4. Investment and Owner Occupied Properties	0.71	0.7	0.74	0.93	1.08
5. Equities (including demutualisation shares)	13.91	13.67	12.12	14.35	15.59
6. Insurance Policies	38.3	38.45	41.13	40.87	41.34
7. Collective Investment Schemes	12.5	11.48	10.46	10.55	10
8. Hedge Funds	0.28	0.31	0.29	0.32	0.38
9. Private Equity Funds	0.51	0.54	0.35	0.29	0.29
10. Investment in participating employer(s)	0.37	0.34	0.35	0.44	0.42
11. Derivative market instruments	0.03	0.47	0	0.03	0.003
12. Other Assets	0.01	0.02	0.04	0.03	0.03
13. Foreign	20.86	21.2	21.61	20.01	18.7
Total	100	100	100	100	100



REGULATION 28: INFRASTRUCTURE

- Regulation 28 now provides a definition for infrastructure as follows: *“any asset that has or operates with a primary objective of developing, constructing and/or maintaining physical assets and technology structures and systems for the provision of utilities, services or facilities for the economy, businesses, or the public”*.
- There is a 45 % overall limit for infrastructure across all classes (excluding debt instruments issued by, and loans to, the government of the Republic and any debt or loan guaranteed by the Republic).
- The economic crisis due to the Covid-19 pandemic revived the discussion on amending Regulation 28 to allow pension funds to invest directly or more in infrastructure projects and in so doing stimulate the revival of the economy during/post Covid.
- Infrastructure investment is key to efforts to grow the economy, create jobs, empower small businesses and provide services to South Africans (and all those who live in SA). Government has announced an infrastructure investment programme over the next decade of R2.3 trillion. Historically, most infrastructure has been funded by the State, but escalating debt exacerbated by the Covid-19 pandemic (and other factors) has led Government to turn to the private sector, including retirement funds, to potentially fund infrastructure investment. *

* <https://businesstech.co.za/news/government/419869/south-africa-names-first-projects-in-r2-3-trillion- infrastructure-drive/>

REGULATION 28: INFRASTRUCTURE

- The importance of infrastructure investment also finds expression in the OECD Working Paper No.13 where it states that infrastructure expansion generally increases the productive capacity in an economy.
 - The critical significance of infrastructure is, moreover, encapsulated in Goal 9 of the 17 Sustainable Development Goals (SDGs) of the 2030 Agenda—“Build resilient infrastructure, promote sustainable industrialization and foster innovation”.
 - The following key challenges of infrastructure investment were identified:*
- There is limited data on the size, risk and returns correlations, which makes pension investors cautious.
 - High up-front costs, lack of liquidity and long asset life of the projects require significant scale and dedicated resources to understand the risks involved, resources that many investors and small retirement funds are lacking.
 - Not a suitable proposition for all investors.
 - Lack of clarity and detail on investment opportunities.
 - Political risk.

REGULATION 28: INFRASTRUCTURE

- High bidding costs involved in the procurement process of infrastructure projects.
- Infrastructure investment opportunities in the market are perceived as too risky.
- Investor Capability - lack of expertise in the infrastructure sector.
- Misalignment of interests between infrastructure funds and pension funds.
- Short Termism of investors.
- Regulatory Barriers (although not the case in South Africa).
- Negative perception of the infrastructure value.
- Lack of transparency in the infrastructure sector.
- Shortage of data on performance of infrastructure projects, lack of benchmarks.
- Involves new types of investment vehicles and risks for pension funds to manage.

TRENDS IN FOREIGN ASSET ALLOCATION

- Regulation 28(3)(i) states that the aggregate exposure to foreign assets must not exceed the maximum allowable amount that a fund may invest in foreign assets as determined by the SARB, or such other amount as may be prescribed. Based on the SARB's Exchange Control Circular No.10/2022, retirement funds may therefore from 23 February 2023 acquire foreign exposure up to the revised limit of 45%.
- While the foreign investment allocation gives funds the flexibility to invest offshore, it is not the driver for offshore investment. Industry estimates of the optimal offshore holdings in funds range from 38%-40%. Beyond these numbers, the returns begin to diminish, given the relative cost of holding foreign assets in South Africa.
- Fund decisions to invest offshore are driven by a number of factors, which include:
 - The need for diversity and quality of securities, across classes and borders, which is not satisfied by the declining number listings on the JSE;
 - The forex return on offshore investments (\$, €, £ mainly);
 - The performance of foreign assets;
 - Investor demand, whether by own informed choice or by financial advisor recommendation.



ENVIRONMENTAL, SOCIAL & GOVERNANCE FACTORS

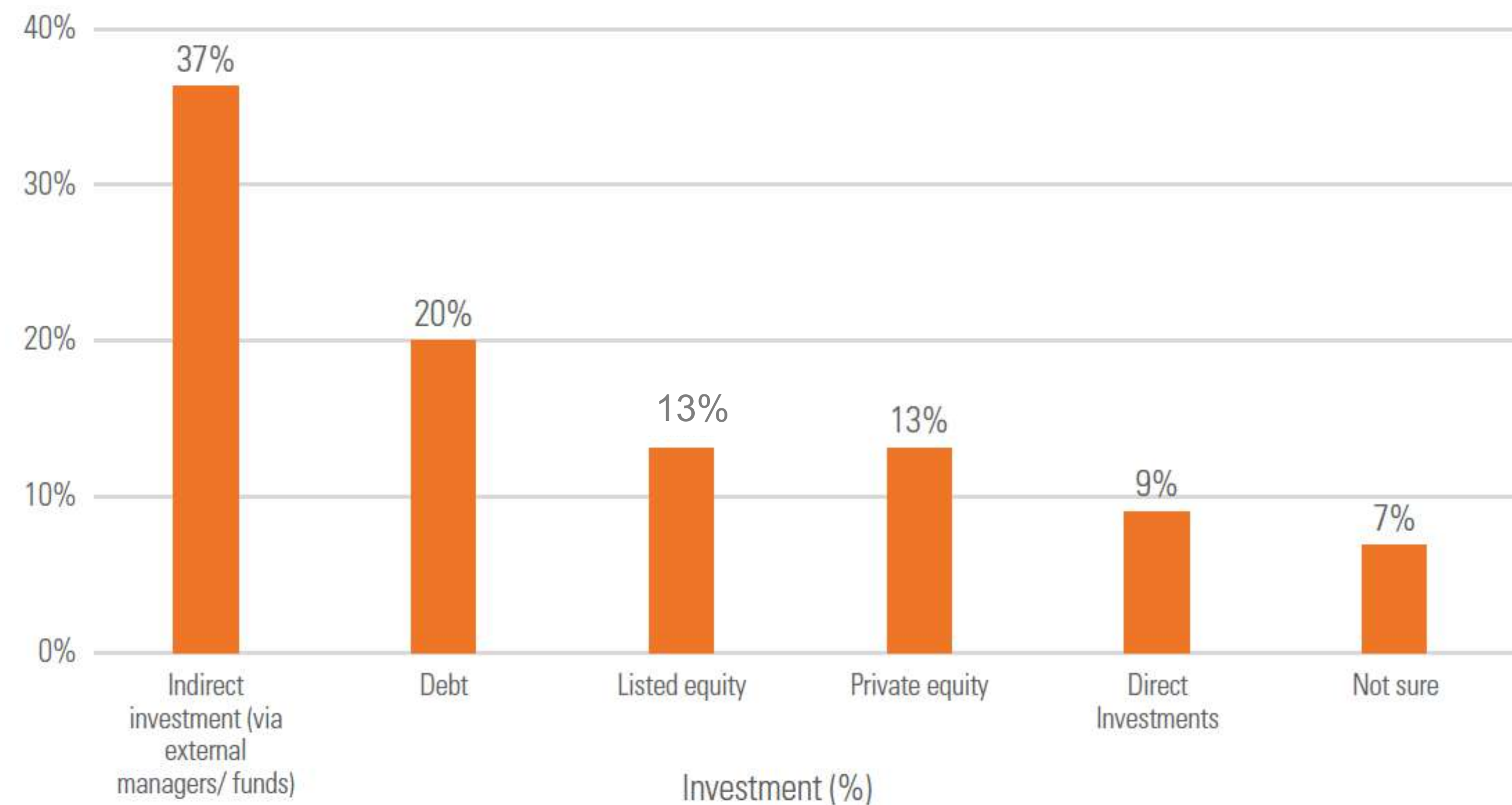
- Regulation 28 promotes the responsible investing of fund assets based on a sustainable, long-term, risk aligned and liability-driven investment philosophy. It requires all retirement funds to have an investment policy statement and for boards of management to consider ESG factors before investing in an asset.
- The FSCA issued Guidance Notice 1 of 2019: Sustainability of Investments and Assets in the Context of a Retirement Fund's Investment Policy Statement, which provides further guidance to retirement funds on how to comply with the provisions of Regulation 28. In particular, how a fund's investment philosophy and objectives, as reflected in its investment policy statement, seek to ensure the sustainability of its investments and assets. The Guidance Notice also sets out the FSCA's expectations regarding certain disclosure and reporting requirements relating to sustainability.
- During 2020, retirement funds completed a survey titled "Sustainable Finance Practices in South African Retirement Funds". The survey aimed to capture the current practices of South African retirement funds, their strategic aspirations and their capacity needs when it comes to sustainable finance.*

* <https://www.fsc.co.za/Documents/South%20Africa%20Retirement%20Funds%20-Sustainable%20Finance%2004-02-21.pdf>

ENVIRONMENTAL, SOCIAL & GOVERNANCE FACTORS

- The survey indicated that the majority of retirement funds that invest in infrastructure do this through indirect investment through external managers/funds. This is followed by investments through debt. Direct investments are the least used category of investments to gain exposure to infrastructure.

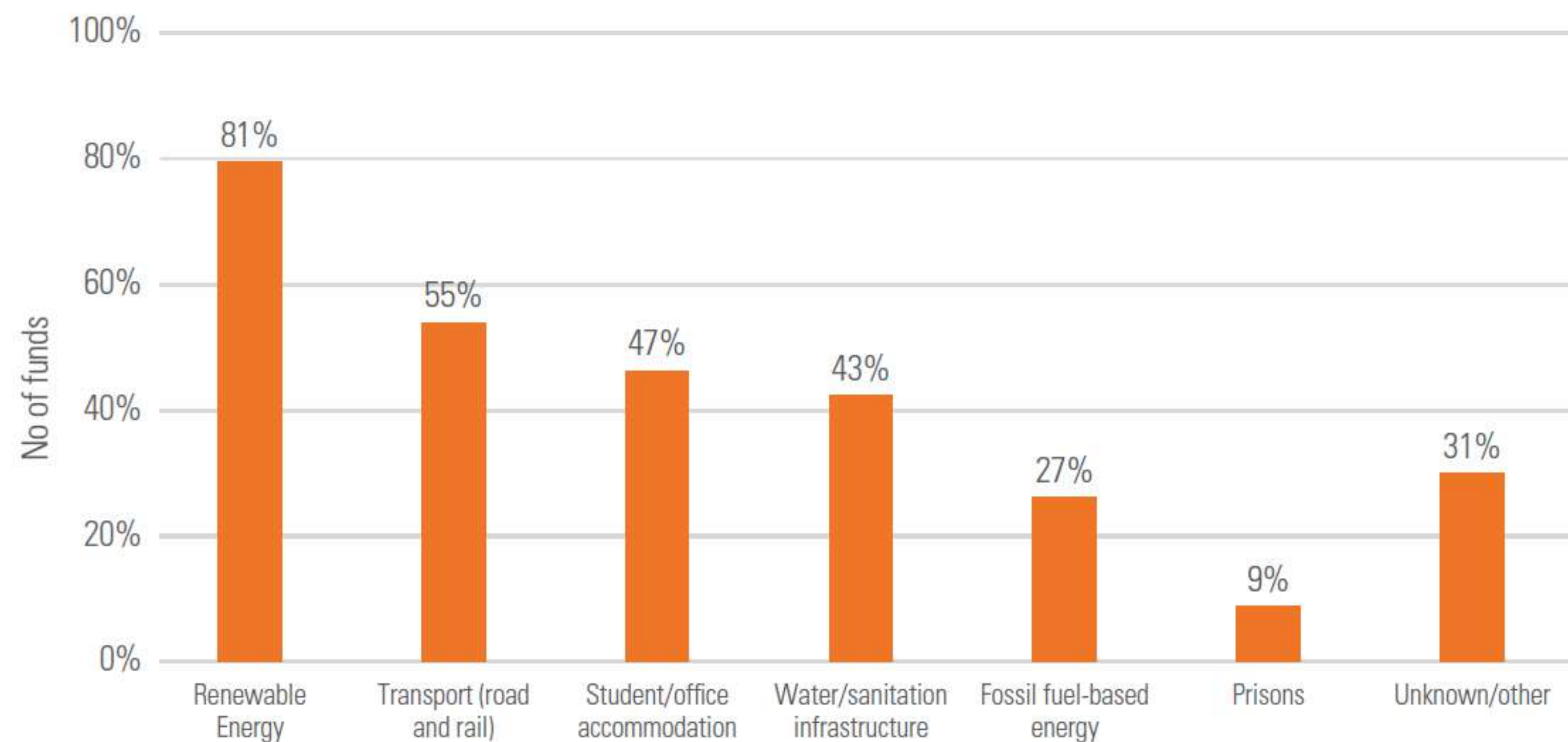
3.1.2.20. Infrastructure exposure breakdown



ENVIRONMENTAL, SOCIAL & GOVERNANCE FACTORS

- The survey further indicated that the majority of retirement funds that invest in infrastructure projects typically invest in renewable energy and transport (roads and rail).

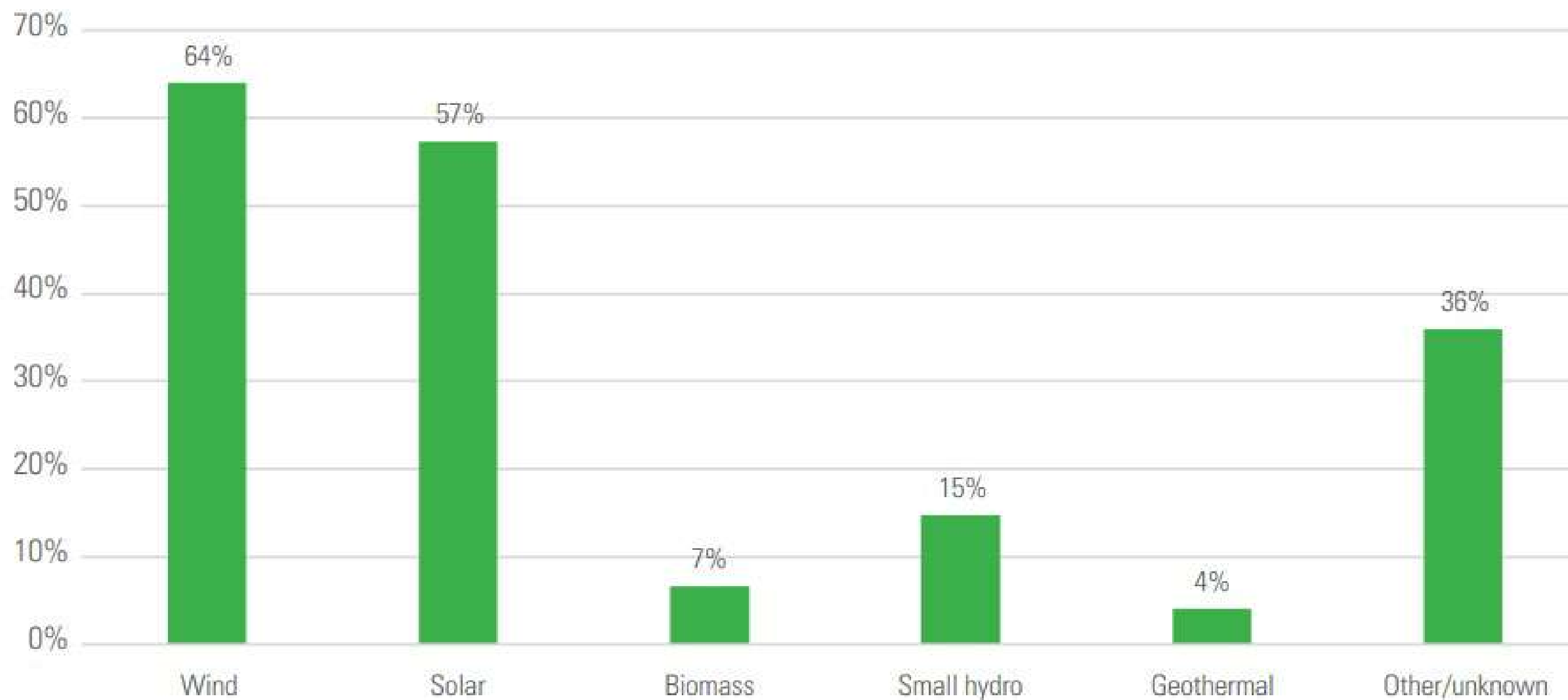
3.1.2.21. Type of infrastructure projects



ENVIRONMENTAL, SOCIAL & GOVERNANCE FACTORS

- The survey further indicated that the majority of retirement funds that invest in infrastructure projects typically invest in renewable energy and transport (roads and rail).

4.1.5. Type of utility scale renewable energy generation investments



ANNEX: ESG FACTORS – SURVEY RESULTS

- 139 respondents (represent 74% of retirement assets under management).
- R40 billion reported investments by retirement funds in green assets (R4.26 trillion total assets under management).
- 81% (weighted) of responding retirement funds have invested in renewable energy.
- 99% (weighted) of responding retirement funds have an investment policy statement which integrates the management of environmental, social, and governance (ESG) aspects of investments.
- 82% (weighted) of responding retirement funds would be willing to increase allocations to green and climate-focused investments.
- The following key challenges emerged from the survey:
 - ❖ The lack of agreed and consistent industry definitions of green, social, and sustainability-focused assets, projects, and sectors currently makes it a costly exercise for funds to require asset managers to track and report on these asset allocations in fund portfolios.
 - ❖ Insufficient pipeline of investments that meet the requirements of retirement funds, good governance issues, liquidity, ESG credentials and financial returns.

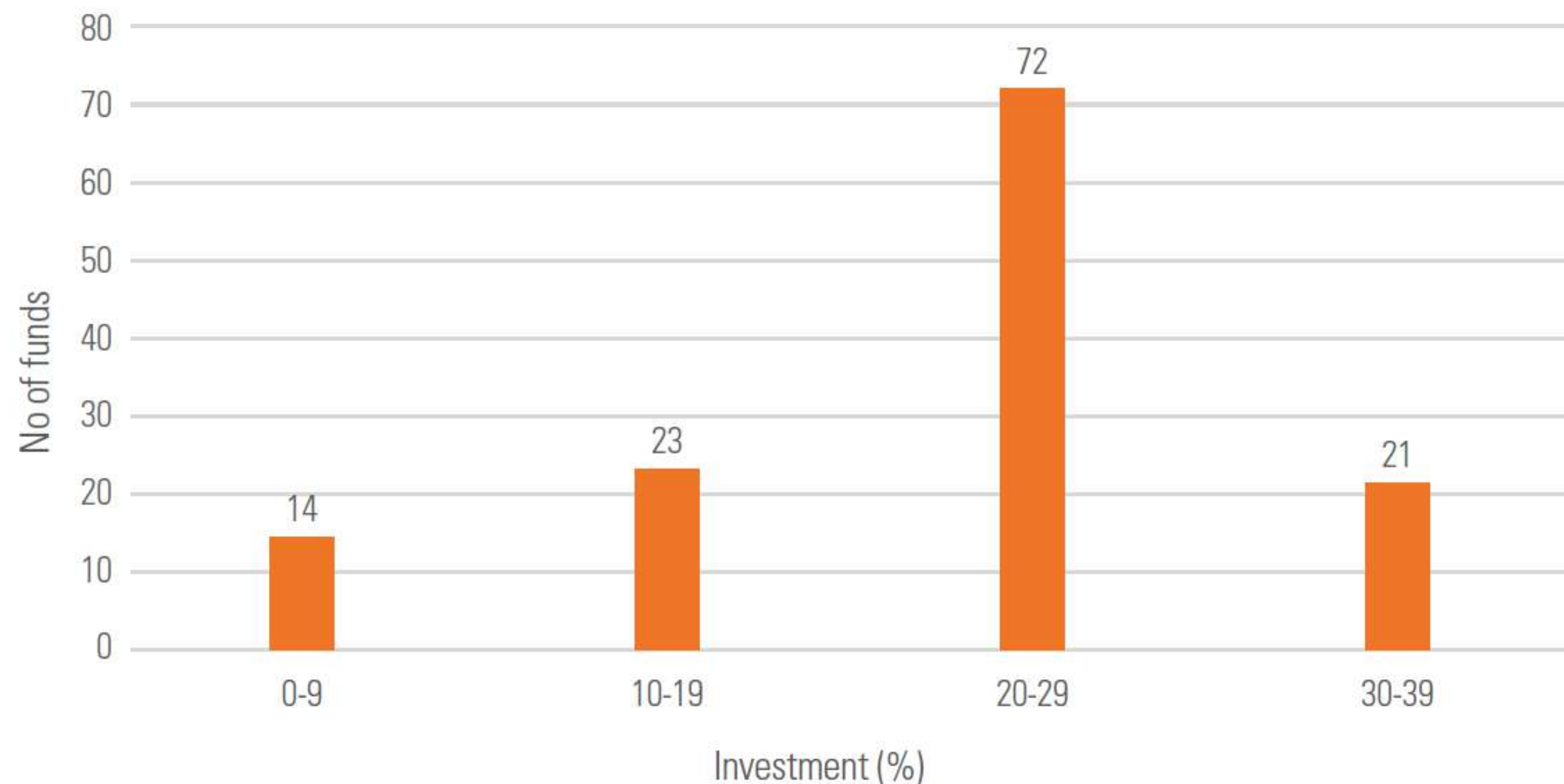
ANNEX: ESG FACTORS – SURVEY RESULTS cont.

- ❖ The constraints expressed by pooled and retail retirement funds, such as being able to influence the ESG mandates of their investments.
- ❖ Integration of ESG and sustainable finance strategies requires new expertise among retirement funds, asset consultants, and asset managers.
- The following opportunities emerged from the survey:
 - ❖ An agreed national green and social taxonomy would facilitate harmonised monitoring and reporting across the pension funds industry and enable retirement funds to make more informed decisions about asset allocation and the selection of investment products.
 - ❖ Growing interest and appetite among South African pension funds to allocate capital to sustainable assets.
 - ❖ Coordination between pension funds and asset managers to agree on collective ambitions for green, social, and sustainability-focused investment options and targets.
 - ❖ Green and climate-focused investing aspirations need to consider social development in South Africa's economy.

ANNEX: ESG FACTORS – SURVEY RESULTS cont.

- The survey provided statistics regarding the percentage of retirement funds' assets which were invested **offshore** (excluding Africa).

3.1.2.19. Investment in offshore assets



ANNEX: ESG FACTORS

- National Treasury published an updated version of the Technical Paper titled “Financing a Sustainable Economy” in 2021.
 - National Treasury Climate Risk Forum was established to take forward the recommendations of the Technical Paper.
 - ❖ Comprised of representatives from government (including FSCA and PA), industry and civil society.
 - Key outputs have already been issued:
 - ❖ South African Green Finance Taxonomy
 - ❖ Principles and Guidance for Minimum Disclosure of Climate Related Risks and Opportunities
 - ❖ Draft Sustainable Finance Handbook for South Africa
- The Responsible Investment and Ownership (RIO) Guide has been issued to assist boards of retirement funds to integrate ESG factors into investment decisions.
 - The Retirement Funds Supervision Division (FSCA) is in the process of incorporating the reporting requirements in the annual financial statements of retirement funds.
 - The RIO Guide is endorsed by various organisations and associations including ASISA, IFC, FSCA, GEPP, IISA, PRI, COSATU (Organisations and associations contributed to the RIO Guide as well).



ANNEX: ESG FACTORS

- The RIO Guide provides seven steps to guide pension funds policy development and management process:*
- 1. Developing a Policy
- 2. Setting Targets and Timelines
- 3. Establishing ESG Committees and Training Needs
- 4. Selecting Service Providers
- 5. Monitoring
- 6. Disclosure and Reporting
- 7. Review Process



South Africa's retirement fund industry is one of the largest in the world. The investment decisions of the country's retirement funds have a direct and indirect bearing on pensioners, society and environment they will retire in.

Their size means that they have unprecedented power to champion and secure sustainable long-term returns by insisting on high standards of environmental care, social concern and better governance (ESG factors) in the assets in which they invest.

Olano Makhubela, FSCA

* <https://rioguide.batseta.org.za/>

ANNEX: ESG FACTORS

- King Committee on Corporate Governance and King Code aims to promote corporate governance in South Africa and establishes recommended standards of conduct. It encourages the practice of good financial, social, ethical and environmental practice.
 - The King IV Report Principles have been incorporated into the CoFI Bill.
- Code for Responsible Investing in South Africa (CRISA) contains five voluntary principles for stewardship and responsible investment as a key component of the South African governance framework. It is endorsed by ASISA, Batseta, FSCA, GEPP and IoDSA.
- Financial Sector Code (FS Code) is the outcome of interaction and negotiations between financial sector trade associations, the Association of Black Securities and Investment Professionals (ABSIP), Organised Labour, Community and Government. The FS Code reflects the accord reached by all the stakeholders regarding their joint commitment to fostering B-BBEE in the financial sector.
 - The Retirement Fund Scorecard sub-committee was established in February 2019 to submit and discuss proposals from various constituencies (including FSCA and National Treasury) regarding the review of the Retirement Fund Scorecard.





ANNEX: ESG FACTORS

- The reviewed retirement fund scorecard will be compulsory once enacted. The COFI Bill will enable the FSCA to issue conduct standards to enforce the reviewed Retirement Fund Scorecard once enacted.
- The FSCA is in the process of incorporating IFRS Sustainability Disclosure Standards as well as TCFD disclosure recommendations into the annual financial statements of pension funds.
- The FSCA partnered with the IFC for a series of awareness and in-depth training sessions to increase the FSCA's capacity to assess and supervise progress made by funds in terms of the ESG integration requirements in Regulation 28.
 - The same training is provided to retirement funds to ensure that the FSCA and the Retirement Funds Industry have similar capacity building strategies.
- The FSCA launched the first eleven modules of the newly revamped Trustee Training Toolkit on 26 September 2023. The Investments module of the new Toolkit has an ESG component which aims to enhance trustees' knowledge and skills regarding the topic and to better equip them in the exercise of their fiduciary duties.

ANNEX: ESG FACTORS

- The FSCA published “FSCA Statement on Sustainable Finance and Programme of Work” in March 2023.
 - Informed by its conduct mandate, the FSCA has developed a programme of work for sustainable finance, made up of five pillars. Each pillar will be informed and supported by capacity building; research and stakeholder engagements; regulatory and supervisory framework development; and coordination and cooperation with other stakeholders.

FSCA Programme of Work:

1.	2.	3.	4.	5.
Taxonomy	Disclosure, reporting and assurance	Market development	Active ownership	Consumer education
<i>Capacity building</i>				
<i>Research and stakeholder engagement</i>				
<i>Regulatory and supervisory framework development</i>				
<i>Coordination and cooperation with other stakeholders</i>				



ANNEX: ESG FACTORS

- Sustainability would promote FSCA objectives especially in maintaining financial stability. The financial markets performed dismally at the onset of the pandemic. COVID-19 laid bare the societal challenges faced by the majority of the citizens of South Africa. It is important to mitigate future ESG risks as they pose a significant threat to pension fund investments.
- “In South Africa, ESG performance has been linked to better gross returns and investment performance for leaders in the space. Between 2007 and 2022, large and mid-cap JSE-listed companies on the MSCI South Africa ESG Leaders Index consistently outperformed their peers in terms of gross returns.”
- South African ESG research firm FarSight, which focuses its research on determining a leadership score for ESG issues, confirmed that firms with good leaders (that respond to ESG) typically outperform those with poor leaders”.

THANK YOU