Trustee Tutor 23:
The evolution of retirement funds in South Africa

The evolution of retirement funds in South Africa over the past 3 decades reflects the profound social, economic and legislative transformations shaped by the country's politics, economic environment, digital innovation and regulatory reforms. What's more, our local industry forms a substantial portion of the country's wealth, and thus, is also impacted by changes in the global environment.

As our country and the world advances, so too must our thinking.

This issue of Trustee Tutor explores the major shifts that retirement funds have experienced in their:

- Benefits and legislation
- Investment products and strategies

Looking back at how the retirement industry has changed from a paternalistic, employer-controlled system to a member-centric, transparent and diversified financial environment, gives us pause to reflect and anticipate the future opportunities that may present themselves to better serve fund members.

Evolution in the benefits and legislation

Since the late 1980s, the benefits provided by retirement funds in South Africa have changed significantly.
These advances have been driven by changes in:

- Global experience and advancements,
- Social demands, the collective priority and societal expectations,
- Economic and commercial conditions,
- Legislative and regulatory frameworks, and
- Innovations in technology.

Shift in focus to simplicity & transparency

The employee benefit funding model – the start of major changes
In the late 1980s, South African retirement funds were largely dominated by defined benefit (DB) schemes, where retirement benefits were calculated based on an employee's final salary and years of service.

DB funds in action …

An employee who retired earning a salary of R50 000per month, after working for a company for 30 years, might receive a pension of 2% of their final salary per year of service. In other words, they would receive a monthly pension of R30,000 (30 years × 2% × R50,000) in their retirement.

This pension referenced in the example was guaranteed by the fund, regardless of investment performance. So while DB funds gave pensioners a predictable income in their retirement, they placed considerable financial risk on the employer. Employers were responsible for funding any shortfalls between the benefits promised in the fund's rules and the fund's assets needed to pay those benefits.

These DB pension funds were set up by the employer for their employees only, were mostly employer-managed and provided security with little risk for employees. But they also offered very limited flexibility and severely restricted the amount an employee would receive when they resigned before retirement. The benefits were often described as “paternalistic” because employees had little choice in managing their funds.

By the early 1990s, South Africa's political landscape was changing, ushering in a new era of inclusion, opportunity and self-direction.

Retirement funds responded by providing more transparency and simplicity through a move to defined contribution (DC) funds, and offering accessibility and portability through the advent of provident funds. This transition was partly driven by trade unions advocating for better resignation and withdrawal benefits, and the inclusion of previously excluded employees.

DC funds in action …

In a defined contribution fund, the member is entitled to their full fund value when they leave the fund. And their fund value is made up of all the contributions paid for and by that member, less the fund expenses and insurance premiums (if any), plus investment return.

While the move to DC provident funds provided very simple, flexible and attractive benefits, it also shifted the investment risk onto the member – a feature of retirement funds that we still have today.

Portability is the ability to take something with you when you move or change jobs. In the context of retirement funds, portability means you can transfer your retirement savings from one fund to another without losing your benefits.

INTERESTING FACT

Currently it is estimated that more than 90% of all retirement funds registered in South Africa are DC funds.

Fostering inclusion

1996 – member elected trustees becomes mandatory
The Pension Funds Amendment Act 11 of 1996 introduced the requirement for member representation on retirement fund boards, giving member a voice in the running of their funds.

Retail products offer retirement fund members tax efficient options

The late 1990s saw the introduction of preservation funds to enhance portability and flexibility, by giving members the option to transfer their retirement fund values tax free when they left employment.

Similarly, retirement annuities (RAs) gave individuals, particularly those who were self-employed, a personal pension plan with tax incentives.

The introduction of living annuities in the 2000s marked a significant innovation in post-retirement benefits.

Enhancing fairness & real-time transparency

Daily unitisation is the practice of allocating the underlying daily investment returns to retirement fund member values every day.

Then came surplus apportionment

Amendments to the Pension Funds Act in 2001 introduced surplus apportionment – which mandated the fair and equitable sharing of any surplus assets in a retirement fund between employers and members/pensioners. The surplus legislation made sure that fund members receive the full allocation of retirement savings contributions plus the investment returns earned thereon when they leave a fund.

Daily unitisation – tech needs to keep up with retirement fund administration

The surplus legislation made it very difficult for funds to build up any form of surplus or excess assets, necessitating funds to update members' values with investment returns as regularly as possible. Daily unitisation emerged as part of broader financial market modernisation and technological advancement.

Daily unitisation paved the way for today's retirement fund member and investor who wants real-time insights into their savings, especially in volatile markets.

Focus on cost management

As the understanding of DC funds as well as the compliance burden of retirement funds grew, members and trustees soon realised that one of the levers to maximising their retirement benefits was minimising costs. In other words, the less spent on fees, the more would go towards their individual fund value.

The move to umbrella funds

In response to the call for effective cost management, umbrella funds started to grow in popularity from the later 2000s. As an alternative to standalone retirement funds, which serve only one employer, umbrella funds provide a retirement fund solution for many employers.

While standalone funds have a dedicated board of trustees and are independently managed, umbrella funds pool many different employers into a single, larger fund established by a professional sponsor, often a financial services provider.

This has allowed for considerable cost efficiencies, improved governance and better regulatory compliance, especially benefiting small to medium-sized employers that lack the resources to manage their own funds effectively. Umbrella funds offer participating employers flexibility with sub-funds, economies of scale and professional administration, leading to better value for both employers and employees.

INTERESTING FACT

TFSAs remain a popular investment vehicle for South African investors and research shows that the majority of people who have TFSAs also have financial advisors.

Over time, the Financial Sector Conduct Authority (FSCA) has supported the shift toward umbrella funds to streamline their supervision efforts and make these more effective. Consequently, South Africa has seen a steady reduction in standalone funds as consolidation into umbrella funds increases.

Reforms to support the national savings imperative

Since 2010, National Treasury has driven retirement reform to enhance financial security, promote equality and address economic challenges. In reality, South Africa's household savings rate is dire - a consequence of high unemployment, rising living costs and stagnant wages.

Tax-free savings accounts: 1 March 2015 – encouraging tax efficient savings
In their 2024 Budget, National Treasury announced the introduction of tax-free savings accounts (TFSAs) from the 1 March 2025 fax year. The intention of TFSAs is to encourage household savings by providing tax-exempt investments to certain limits. TFSAs allow South Africans to contribute up to R36 000 annually and R500 000 over their lifetime, with no tax on interest, dividends or capital gains. Withdrawals are also tax-free.

T-Day: 1 March 2016 – all funds are made the same
The Taxation Laws Amendment Act (TLAA) harmonised the tax treatment of pension, provident and retirement annuity funds by standardising:

- Contribution deductions (27.5% for all funds, capped at R350 000) and
- Retirement benefits (maximum of ⅓ in cash, the balance of ⅔ used to buy a pension)

These reforms encouraged preservation of long-term savings for retirement rather than lump-sum withdrawals.

Default Regulations: 1 March 2019 – reducing the impact of poor financial literacy
In March 2019, retirement funds were required to put default strategies in place for members who don't:

1. Make a choice of which portfolio to invest their retirement savings in (default investment strategy),
2. Indicate what to do with their fund value when they left their job (default preservation strategy),
3. Understand what annuity to invest their savings in when they reached retirement (trustees' endorsed annuity strategy – note: this is not a default)
4. Know how to prepare for their retirement (retirement benefit counselling)

By setting out guidelines on how trustees should structure and communicate their defaults, these regulations help safeguard members' retirement outcomes and reduce the risk of poor financial literacy undermining retirement benefits.

Two-pot system: 1 September 2024 – short-term emergencies meets long-term planning
Building on T-day reforms, the two-pot system now provides retirement fund members with:

- A savings pot: ⅓ of monthly contributions go into a savings pot, which a retirement fund member can access annually.
- A retirement pot: ⅔ of monthly contributions go into a retirement pot, which members are forced to preserve until retirement. (In other words, members no longer have access to their full benefit as a lump sum when they leave employment.)

It is expected that the two-pot retirement system will grow retirement savings over the long term, as retirement fund members are no longer able to receive their benefits as a cash lump sum on withdrawal.

Keeping information safe

The evolution of big data and digital innovation around the world has ushered in the new age where personal information and data are valuable assets.

Data is the new oil: Joint Standard 2 of 2024 on cybersecurity and resilience – 1 June 2025
Retirement funds are rich in both personal information and assets, making them very attractive to cybercriminals who may wish to use the data for ill purposes or hold the fund or its administrators to ransom. Joint Standard 2 of 2024 on cybersecurity and resilience sets the standards for today's retirement funds to protect these valuable assets. This firmly puts us in a world where trustees need to not only understand retirement fund law, but also the tech and security in place to manage and protect their funds and their investments.

Evolution in industry supervision

A look at the evolution of benefits and regulation would not be complete without a mention of the developments in the supervision or regulatory bodies in place to monitor financial practices and behavioural conduct.

The Financial Sector Regulation Act of 2017, birthed the twin-peaks model of financial supervision in South Africa by separating regulatory oversight into two pillars:

1. Prudential regulation: Prudential Authority, overseen by the South African Reserve Bank
   Ensures the financial stability and soundness of financial institutions by regulating their solvency, risk management and governance practices.
2. Market conduct: Financial Sector Conduct Authority (FSCA)
   Responsible for ensuring financial institutions treat customers fairly, promoting transparency, market integrity and financial education, while maintaining the stability and efficiency of the country's financial markets.

This model which came into effect in 2018, enhances accountability and aligns with global standards. For retirement funds, it strengthens governance and transparency.

Evolutions in Investment Products and Strategies

The changes in the macro environment and the benefits provided by retirement funds, have influenced the types of investment products available and the strategies implemented by retirement fund trustees, their asset consultants and asset managers/multi-managers to optimise returns while managing risk.

Economic context and market volatility
The transition to democracy in 1994 opened the economy to global markets, increasing opportunities for offshore investments but also exposing funds to currency volatility and global market fluctuations.

As you know, at the same time, we saw employers move to defined contribution funds, meaning that members take on the investment risk in their retirement savings.

INTERESTING FACT

According to the 2025 Sanlam Benchmark Survey™, 60% of retirement funds use multi-managers for their default investment strategies.

Risk management through diversification

Volatile markets means risk for investors. And as members started taking on the investment risk in their retirement funds, diversification became an essential mitigation strategy.

Meaningful investment manager diversification – the rise of the multi-manager
Multi-managers became popular in South Africa from the late 1990s and early 2000s as retirement funds and investors sought diversified investment approaches that reduce risk and enhance returns by combining different asset managers' expertise and strategies. Instead of trustees or management committees having to choose single asset managers, they are now able to set an investment objective and then choose an investment portfolio that meaningfully combines a number of asset managers best positioned to meet that objective.

Geographic diversification – offshore investment limits increase over time
The relaxation of exchange controls and the increase in Regulation 28's offshore investment limits over the last 20 years, to 45% in 2022 have enabled funds to diversify globally. This shift allows access to more stable currencies, advanced technologies and industries not represented in South Africa's concentrated market. Asset managers have increasingly allocated funds to global equities, bonds and other asset classes to enhance returns and reduce risk.

Regulation 28 of the Pension Funds Act limits how retirement funds in South Africa can invest by setting maximum exposure limits to different asset classes. The intention is to ensure diversified portfolios and protect members' retirement savings from too much risk.

Asset class diversification – increasing popularity of alternative investments
Alternative investments, like private equity and hedge funds, have grown in popularity from 2011, when Regulation 28 was amended to allow up to 15% in private equity and 10% in hedge funds.

The desire to do good with our investments

In 2004 the term ESG was born in a United Nations initiative called "Who cares wins". Since then, the necessity of investing with motives other than seeking the best returns, has gained momentum. In September 2015, the United Nations officially adopted the Sustainable Development Goals (SDGs) as a global framework for addressing environmental, social and economic challenges through 17 universal goals.

ESG stands for Environmental, Social and Governance and is a set of standards used to measure how responsibly and sustainably a company operates.

Protecting our world
By incorporating ESG factors into their investment strategies, retirement funds are able to meaningfully impact the world around them. This includes supporting environmental issues by not investing in companies that damage the environment, or by penalising poor governance practices that are unfair or unethical by disinvesting from businesses that are not well run.

INTERESTING FACT

Since the 2011 amendments, Regulation 28 explicitly requires retirement funds to consider ESG factors as part of their investment decisions.

Reporting on ESG efforts

In 2022, the Johannesburg Stock Exchange (JSE) released its Sustainability Disclosure Guidance and Climate Change Disclosure Guidance to promote transparency and good governance among listed companies. The JSE is currently reviewing this guidance to align with the International Sustainability Standards Board's (ISSB) IFRS S1 and IFRS S2 standards, published in June 2023.

Shareholder activism is when shareholders use their ownership rights in a company to influence its management, strategy or policies. Activist shareholders can push for changes by engaging with the company's board, submitting shareholder resolutions, running proxy battles to elect new directors, using media campaigns or even pursuing legal action to hold executives accountable. Their goals can include improving financial performance, enhancing corporate governance, promoting social or environmental responsibility, or pushing for greater transparency. Although shareholder activism has been around since the late 1980s, it is still growing support in South Africa's retirement fund industry.

Building our country - Infrastructure investing
Infrastructure investments, particularly in renewable energy and transport, have gained traction as South Africa addresses its infrastructure deficit. These investments offer long-term returns aligned with retirement funds' horizons while supporting economic development.

In the 2025 Budget Speech, the Minister of Finance announced a major commitment to infrastructure investing, with over R1 trillion allocated over the next three years towards renewing and expanding roads, ports, rail, energy and water systems. This investment aims to drive economic growth, job creation and improved service delivery.

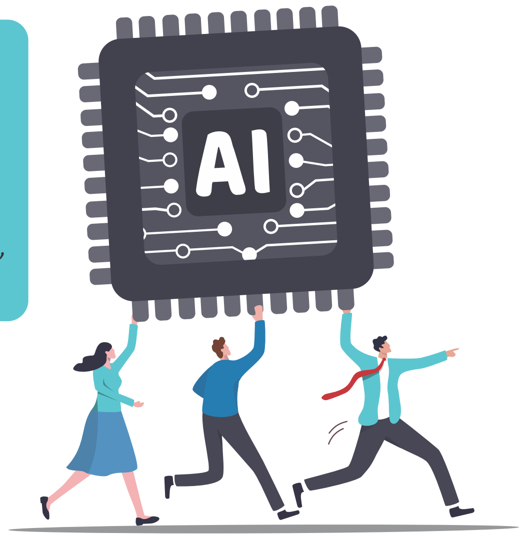
The 2023 amendments to Regulation 28 incorporated a definition of infrastructure in the regulations, as any asset that has or operates with a primary objective of developing, constructing and/or maintaining physical assets and technology structures and systems for the provision of utilities, services or facilities for the economy, businesses or the public.

It is important to note that Regulation 28 doesn't categorise infrastructure as a separate or new asset class. In other words, the main asset classes for retirement funds remain cash, bonds, equities, property, hedge funds and private equity. Through these asset classes, funds may invest up to 45% of their assets in infrastructure investments.

So where are we now?

As we reflect on the changes over the last three decades, we find ourselves as an industry where retirement benefits and investments:

- Must encourage financial inclusion.
- Require high levels of governance, compliance and ethical management.
- Operate in a digitally advanced world – where AI promises enormous efficiencies.
- Need to offer value for money and easy access to information.
- Demand flexibility and hyper-personalisation of benefits to meet members' actual needs.
- Gives members the satisfaction of knowing their investments are used for more than simply financial returns, but also to do good in the world.
- Need to integrate with the rest of an individual's financial planning, as part of a holistic package of health, wellness, debt management, insurance, tax and estate planning.



This presents the industry with infinite opportunities for innovation.

Trustee Tutor 23:
The evolution of retirement funds in South Africa

How to?

The assessment for this issue of Trustee Tutor follows for information and/or training purposes. If you would like to earn verified CPD hours for reading this issue, please go to www.pensionsworldsa.co.za/cpd-portal/ and complete the assessment electronically to receive your certificate immediately on meeting the competency requirements.

1. When compared to defined benefit funds, defined contribution funds provide members with benefits that are:
a. Transparent ☐
b. Simple ☐
c. Flexible ☐
d. All of the above ☐

2. The requirement for boards of trustees to include member trustees came into effect in:
a. 1994 ☐
b. 1996 ☐
c. 1998 ☐
d. 2000 ☐

3. Portability means you can transfer your retirement savings from one fund to another without losing your benefits.
a. True ☐
b. False ☐

4. TFSAs allow South Africans to contribute up to R_____ annually and R_______ over their lifetime, with no tax on interest, dividends or capital gains.
a. R24 000; R400 000 ☐
b. R30 000; R500 000 ☐
c. R36 000; R500 000 ☐
d. R36 000; R600 000 ☐

5. On 1 March 2016, the Taxation Laws Amendment Act (TLAA) harmonised the tax treatment of pension, provident and retirement annuity funds by standardising:
a. Contribution deductions at 27,5%, and R350 000 pa, for all funds ☐
b. That all funds needed an investment default strategy for members who didn't make investment choices ☐
c. Retirement benefits as ⅓ can be taken in cash and ⅔ must be used to provide a pension ☐
d. a and c ☐

6. Choose the incorrect answer. In March 2019, retirement funds were required to put default strategies in place for members who don't:
a. Make a choice of which portfolio to invest their retirement savings in (default investment strategy), ☐
b. Indicate what to do with their fund value when they left their job (default preservation strategy), ☐
c. Understand what annuity to invest their savings in when they reached retirement (default annuity strategy) ☐
d. Know how to prepare for their retirement (retirement benefit counselling) ☐

7. 2017 saw the inception of the twin peaks regulatory model in South Africa, where:
a. The PFA supervises the conduct of financial institutions and the FSCA ensures their stability and soundness. ☐
b. The FSCA supervises the conduct of financial institutions and the FSB ensures their stability and soundness. ☐
c. The FSCA supervises the conduct of financial institutions and the PA ensures their stability and soundness. ☐
d. The PA supervises the conduct of financial institutions and the FSCA ensures their stability and soundness. ☐

Trustee Tutor 23:
The evolution of retirement funds in South Africa

8. According to the 2025 Sanlam Benchmark Survey™, __% of retirement funds use multi-managers for their default investment strategies.
   - a. 60 ☐
   - b. 50 ☐
   - c. 40 ☐
   - d. 30 ☐

9. In 2022, Regulation 28 was amended to allow retirement funds to diversify their investments by investing up to __% offshore.
   - a. 25 ☐
   - b. 35 ☐
   - c. 45 ☐
   - d. 55 ☐

10. Infrastructure investments, particularly in renewable energy and transport, have gained traction as South Africa addresses its infrastructure deficit. These investments offer short-term returns aligned with retirement funds' horizons while supporting economic development.
   - a. True ☐
   - b. False ☐