

ANALYSIS | RETIREMENT FUNDS

ESG Reporting in South African Pension Funds: From Voluntary Disclosure to Comply-or-Explain What Has It Cost Members?

There is broad acceptance today that environmental, social and governance (ESG) considerations are firmly embedded in the South African retirement fund landscape. What began as a voluntary, principle-driven framework has evolved into a de facto compliance expectation, shaped by Regulation 28 of the Pension Funds Act. The Code for Responsible Investing in South Africa (CRISA), and guidance from the Financial Sector Conduct Authority (FSCA). ESG is no longer peripheral. It is now positioned as a core component of fiduciary responsibility. Beneath this broad consensus, however, lies a more difficult and largely underexamined question: *what has ESG truly cost pension fund members, critically, are those costs proportionate to the benefits ultimately delivered?*

1. The Regulatory Journey: A Framework That Keeps Expanding

South Africa has been a pioneer of responsible investment in emerging markets, a distinction worth acknowledging while also interrogating. The trajectory from voluntary principle to structured mandate unfolded over two decades. Each phase adding regulatory weight to an already complex operating environment for fund trustees.

2004: The JSE SRI Index: An Early Signal

The Johannesburg Stock Exchange (JSE) became the first emerging market bourse to establish a Socially Responsible Investment (SRI) Index in 2004. While it carried no mandatory force, it set a market signal that sustainability considerations were beginning to matter to institutional capital. Pension funds could engage or ignore it; a freedom that was progressively eroded in the years that followed.

2011: Regulation 28 and the Fiduciary Embedding of ESG

The amended Regulation 28 of the Pension Funds Act, effective July 2011, represented the most significant shift. For the first time, ESG was not merely encouraged, it was framed as an element of fiduciary duty. The Regulation's preamble states that a fund has a fiduciary duty to act in the best interests of its members. It adds that prudent investing should consider any factor that may materially affects long-term performance, and this includes environmental, social, and governance (ESG) factors.

Simultaneously, the first Code for Responsible Investing in South Africa (CRISA) was launched in 2011, making South Africa the second country after the United Kingdom to formally embed ESG into institutional investor expectations. The effective date for reporting on CRISA's principles was 1 February 2012. The code applied to pension funds, asset managers and service providers, and the application mechanism was "apply or explain". This meant that funds were required to demonstrate how they applied ESG and if not, they needed to provide a clear and reasoned explanation.

2019: FSCA Guidance Note 1: Raising the Reporting Bar

In June 2019, the FSCA published Guidance Note 1 on the Sustainability of Investments and Assets, providing funds with detailed expectations on how to comply with the ESG requirements already embedded in Regulation 28. The note required investment policy statements (IPS) to include the board's processes for evaluating sustainability, its active ownership policy, and the monitoring of ESG factors across the portfolio. The FSCA also encouraged funds to publish their IPS publicly which was a transparency nudge that gradually raised reputational and supervisory pressure on non-compliant funds.

2022: CRISA 2: From 'Apply or Explain' to 'Apply and Explain'

The second edition of CRISA, released in 2022, introduced a meaningful terminological and practical shift. The regime moved from "apply or explain" to "apply and explain." Under this formulation, application of the principles is implicit; explanations should demonstrate how the principles are being applied, not justify why they are not. Funds can no longer simply opt out with a narrative. Instead, they are expected to engage actively with each principle and account for their conduct accordingly.

This shift is subtle in language but significant in expectation. It reflects a regulatory stance that has moved well beyond mere disclosure and into active governance accountability.

2022–2025: Prudential Standards and the Broadening Mandate

Financial Sector Conduct Authority Prudential Standard 1 of 2023 initially proposed a holistic reporting approach. It required funds to report on assets held in compliance with Regulation 28 and also covered infrastructure allocations and ESG disclosures.

Industry pushback followed, citing timing pressures and the broad scope of the requirements and in response, the regulator scaled back these specific obligations. However, the current prudential reporting framework still mandates that the investment schedule include ESG data, with detailed schedules to follow in a separate FSCA determination.

At the corporate level, the Companies and Intellectual Property Commission (CIPC) introduced mandatory ESG reporting alongside eXtensible Business Reporting Language (XBRL) filing from 2025 initially targeting public and state-owned entities. Ongoing consultations around adopting the International Sustainability Standards Board's (ISSB) IFRS S1 and S2 frameworks signal that the reporting bar will continue to rise and that pension funds will inevitably be drawn further into this expanding architecture.

Regulatory Timeline at a Glance

Period	Regulatory Regime	What Changed	Cost Impact on Members
Pre-2011	Voluntary Disclosure	JSE SRI Index (2004). No formal ESG mandate. Funds operated with philosophical freedom. Full exposure to governance failure.	Minimal compliance cost; zero ESG protection for members
2011–2019	Reg 28 + CRISA 1 (Apply or Explain)	ESG embedded as fiduciary duty. Funds must consider material ESG factors. CRISA introduces the apply-or-explain transparency regime.	Moderate: IPS drafting, consultant fees, investment constraint costs begin accumulating
2019–2022	FSCA Guidance Note 1 added	Reporting expectations clarified and raised. Active ownership policies required. Disclosure encouraged on fund websites.	Rising: disclosure systems, trustee training, specialist ESG advice
2022–present	CRISA 2 + Prudential Standards (Apply and Explain)	Implicit compliance expected. ESG schedule mandated in prudential reporting. ISSB alignment underway. The 'or explain' option is narrowing.	Elevated and compounding: holistic reporting, data systems, external assurance, valuation premium risk

2. What Has ESG Compliance Actually Cost Members?

This is where honest analysis becomes most difficult and most important. The short answer is that: direct, quantified ESG compliance costs borne by members are not publicly disclosed in South Africa at fund level. This is itself a significant transparency gap, and one that the industry might want to address with some urgency. Nevertheless, the cost landscape can be mapped across four distinct dimensions.

2.1 Direct and Explicit Costs

The growing regulatory burden has generated a new, and permanent layer of costs for pension funds. These include expenditure on ESG data, ratings, and analytics often sourced from global providers at global prices. Reporting requirements have expanded with integrated reporting frameworks demanding more detailed disclosure, supported in many cases by external

assurance. Governance structures have become more complex, requiring trustee training, specialist committees, and, frequently, the appointment of external ESG advisors.

At the investment management level, ESG integration introduces further costs through screening processes, portfolio construction adjustments, and active ownership activities such as engagement and proxy voting. Individually, these costs may appear modest, a few basis points here, a consulting retainer there, but collectively they represent a new and permanent addition to the cost base of retirement funds.

South Africa's pension fund sector is heavily fragmented. The Responsible Investment and Ownership (RIO) Guide for Batseta acknowledges that the sector's fragmented structure affects smaller schemes disproportionately resulting in smaller funds spreading fixed compliance costs across a narrower member base. The per-member cost burden is therefore structurally higher for many South African retirement fund members, who do not belong to large umbrella or public-sector funds.

2.2 Investment Constraint and Opportunity Costs

More significant than direct costs are the indirect effects of ESG on how investment portfolios are constructed. Regulation 28's asset allocation caps, including the 55% domestic requirement, have limited members' exposure to global markets. As a result, they may have missed out on strong returns from developed markets, particularly the technology-driven outperformance of the past decade. This is a structural investment constraint with real return consequences, even if it reflects prudential reasoning that extends beyond ESG alone.

ESG screening layers additional constraints on top of these existing limits and in the South African context, this is a material consideration. The domestic economy remains heavily reliant on resource-based and carbon-intensive sectors which have historically contributed meaningfully to equity market returns. Limiting exposure to these sectors whether through ESG exclusion or significant underweighting can reduce portfolio diversification and result in missed opportunities during commodity upcycles. These are not costs that appear in any fee disclosure; they manifest over time as relative underperformance against unconstrained benchmarks.

2.3 The Valuation Premium Risk

ESG-aligned assets frequently trade at premium valuations, particularly in global markets where institutional demand for sustainable investment vehicles has grown rapidly. This creates a valuation risk that is often overlooked in ESG advocacy because funds may be paying more for perceived quality or ESG compliance, compressing future return potential. When this valuation premium is combined with the additional layers of ESG-related fees data, analytics, stewardship, and reporting the result is a form of cost layering with a meaningful compounding effect on long-term outcomes.

Even a seemingly modest increase in total costs of 0.30% per annum can significantly erode retirement outcomes over a 20- to 30-year investment horizon translating directly into lower retirement income for members.

2.4 Future Generations and the Timing of Costs and Benefits

There is also a broader structural dimension that extends beyond individual cost lines. South Africa's transition towards a more sustainable economy requires substantial capital allocation to infrastructure, renewable energy, and developmental investments all of which are broadly aligned with ESG objectives. However, these investments are typically long-term, illiquid, and subject to significant execution risk. This creates a temporal mismatch: the costs and risks of ESG-aligned capital allocation are borne by current fund members, while the anticipated benefits may only materialise over decades and with no guarantee of delivery.

For defined contribution fund members, who bear all investment risk personally, this trade-off is especially acute. There is no future sponsor balance sheet to absorb shortfalls because the underperformance reduces their retirement income directly and permanently.

ESG Cost Dimensions: How They Arise and Who Pays

Cost Category	How It Arises	Member Impact
Direct & Explicit	ESG data, ratings & analytics (global providers); External assurance on integrated reports; Trustee training & specialist committees; ESG advisory and consulting fees; Reporting infrastructure & systems	Fully borne by fund → passed to members via administration levy or reduced net returns
Investment Constraints	Exclusion or underweighting of carbon-intensive / resource sectors; Missed commodity upcycles in a resource-dependent economy; Portfolio construction adjustments & active ownership costs	Opportunity cost not in a fee line; manifests as relative underperformance over time
Valuation Premium Risk	ESG-aligned assets trade at premium valuations in global markets; Compressed future return potential built into entry price; 'Sustainable' label attached to overvalued assets	Lower future returns for members paying premium prices today
Compounding Cost Drag	Even 0.30% p.a. additional cost drag over 20–30 years materially erodes final portfolio values; Smaller funds bear disproportionate per-member burden	Reduced retirement income the most direct member impact

3. The Case for ESG and Why It Must Be Made Rigorously

None of the above is to argue that ESG lacks merit. The case in its favour is substantive; however, it needs to be made rigorously, not assumed. South Africa's own corporate history illustrates the point with some force.

The collapse of Steinhoff, the unravelling of Tongaat Hulett, and the devastation wrought by state capture at entities such as Eskom, Transnet and SAA all represent catastrophic governance failures that destroyed enormous shareholder value. The value destroyed belonged, in large part, to pension fund members. Strong ESG governance screening, had it been applied with discipline, could plausibly have avoided or reduced exposure to some of these losses. In this sense, the governance dimension of ESG has clear and demonstrable financial relevance in the South African context.

There is also a growing body of evidence, although mixed and context-dependent, suggesting that well-governed, sustainable businesses may deliver superior risk-adjusted outcomes over extended time horizons. Environmental and social factors increasingly affect the long-term viability of businesses and the stability of markets; funds that ignore these signals may expose their members to systemic risks that traditional financial analysis fails to capture.

The question is not whether ESG has merit. It clearly does. The question is whether the cost of ESG compliance, as currently structured in South Africa, is proportionate to the financial protection and value it delivers to members.

The Risk of Compliance-Driven ESG

A clear distinction is emerging between two approaches to ESG implementation. The first is compliance-driven which is characterised by box-ticking, extensive framework adoption, voluminous reporting, and the engagement of multiple service providers without clear linkage to financial outcomes. This approach risks introducing significant cost without delivering measurable member value. Worse, it can provide trustees with a false sense of having fulfilled their ESG obligations while doing little to improve portfolio resilience.

The second is a more integrated, value-driven approach, where ESG considerations are applied selectively and explicitly based on materiality which is the extent to which an ESG factor is likely to affect the financial performance of the portfolio. Under this approach, ESG becomes a component of rigorous investment analysis rather than a reporting exercise. The potential is really leading to enhanced portfolio resilience, better risk identification, and alignment with long-term structural trends. The cost burden, under this model, is purposeful and proportionate.

4. What the Industry Needs to Confront

For ESG to retain credibility in the South African pension fund industry, it must maintain the confidence of members. To do so, the industry needs to confront several uncomfortable realities.

Transparency on costs is non-negotiable

Funds should be able to articulate not only how ESG is implemented, but what it costs and how it affects performance. The absence of fund-level ESG cost disclosure is a structural deficiency. Members, as the ultimate beneficiaries and bearers of these costs, deserve clarity on the trade-

offs being made on their behalf. A meaningful "comply or explain" regime on ESG costs distinct from, but complementary to, the existing ESG integration regime would be a material step forward.

Fiduciary duty must remain the primary lens

Trustees are tasked with acting in the best financial interests of members. When ESG integration imposes additional costs or constrains investment opportunities, trustees must satisfy themselves and be able to demonstrate that these trade-offs are justified by appropriate financial benefits. ESG is frequently presented as inherently beneficial. That claim deserves scrutiny, not deference. The fiduciary obligation runs to members, not to frameworks.

Smaller funds need proportionate standards

The fragmented structure of South Africa's pension fund industry means that regulatory ESG compliance costs fall disproportionately on smaller funds and their members. A proportionate regulatory approach, one that calibrates reporting requirements to fund size, and resources would better serve members in these funds, without diluting the overall integrity of the ESG framework.

ESG must be measured, not merely reported

Disclosure without measurement is noise. The industry needs to move beyond framework adoption and reporting compliance, towards demonstrable measurement of ESG outcomes including their financial impact on member portfolios over time. Until ESG integration is evaluated on the same rigorous return and risk metrics as other investment decisions, it will remain vulnerable to the accusation of being a well-intentioned cost centre rather than a value-creating discipline.

Conclusion: ESG Is Not Cost-Neutral and That Matters

ESG has become a structural feature of the South African retirement fund landscape and that is unlikely to change. The regulatory direction is clear, the momentum is real, and the governance case, in a country with South Africa's corporate history is compelling. However, ESG is not cost-neutral. The evidence, examined with honesty, suggests that it introduces both direct and indirect costs, the burden of which is largely borne by pension fund members.

Some of those costs are already justified by the protection they provide such as governance screening that avoids catastrophic losses and this is worth paying for. Others, particularly in compliance-heavy, framework-layered implementation models, represent cost without corresponding member value.

South Africa has been a pioneer of responsible investment. To remain a credible one, it must now pioneer the next challenge: ESG that is not only principled and transparent, but demonstrably cost-effective for the people it is ultimately meant to serve. The comply-or-explain framework was designed to drive transparency about ESG practice. It is time to extend that principle to ESG costs.

Key Sources & Regulatory References

Regulation 28 of the Pension Funds Act, 1956 (as amended July 2011 and July 2022) | Code for Responsible Investing in South Africa (CRISA), 2011 and CRISA 2, 2022 | FSCA Guidance Note 1 of 2019 on Sustainability of Investments and Assets | Prudential Standard 1 of 2023 (FSCA) | CIPC Notice 6 of 2025 on Mandatory Sustainability Reporting | ISSB IFRS S1 and S2 Standards (June 2023) | RIO Guide for Retirement Fund Trustees, Batseta | JSE Sustainability Disclosure Guidance (2022) | IFC African Pension Funds ESG Landscape Report (2022)