Trustee Tutor 20: Umbrella Funds

An introduction to umbrella funds

Umbrella funds have become an important part of South Africa's retirement savings framework, giving employers a flexible and efficient way to manage their employees' retirement benefits. Because of their increased popularity, it is important that trustees (and other decision makers like management committees), employers and advisors understand how these structures work.

At a high level, umbrella funds allow many, unrelated employers to participate in a single fund, thereby taking advantage of economies of scale. This issue of trustee tutor looks into the legislation governing umbrella funds, current trends, available options and some of the challenges they face.

Let's start at the beginning ... what is an umbrella fund?

Traditionally, employers would set up their own retirement fund to help their employees save for retirement, and provide other benefits like death and disability benefits. Only their employees belong to the fund and there is one set of rules governing the fund. This is known as a standalone fund. A standalone fund is managed by a board of trustees: 50% are appointed by the employer and 50% of whom are elected by the members of that fund.

Umbrella funds, on the other hand, are set up by a sponsor who allow a number of different and unrelated participating employers to join. An umbrella fund has one overriding set of general rules, and each participating employer has their own set of special rules, setting out their specific benefits. One board of trustees manages the whole umbrella fund, and if the rules require it, each participating employer will set up a management committee to manage their particular benefits in the fund.

A **sponsor** is the institution that has set up and registered the umbrella fund.

You can think of an umbrella fund structure as:

UMBRELLA FUND
General Rules
Governed by Board of Trustees

Participating Employer 1	Participating Employer 2	Participating Employer 3
• Special Rules • Management Committee	• Special Rules • Management Committee	• Special Rules • Management Committee

Each participating employer has their own sub-fund

A **participating employer** is an employer who chooses to belong to an umbrella fund.

The umbrella fund's board of trustees is ultimately responsible for the running of the fund, and the choices of benefit options and service provider partners to make available to the participating employers in the fund.

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The **management committee** of each participating employer makes certain decisions relating to their particular section of the fund (or sub-fund), for example, eligibility criteria, contribution rates, benefit structures and investment options for their members.

Umbrella funds are generally cheaper to administer given the economies of scale that the sponsor can achieve by pooling a number of employers, and the simpler structure ensured by a limited set of options. Whilst participating employers may give up some control and flexibility, umbrella funds are less complex and generally need less time and input from an employer.

The **management committee (manco)** is the committee set up to make decisions for their sub-fund. At this stage, a manco is not essential in all umbrella funds and may or may not include member elected representatives. A manco may also be referred to as an employer forum of joint forum.

Legislative framework for umbrella funds

The Financial Sector Conduct Authority (FSCA)

Over the past few years, the FSCA has supported a move of standalone funds into umbrella funds, in a process called consolidation. The FSCA agrees with the principle that umbrella funds are a viable option for smaller employers who may find it difficult and expensive to meet all the compliance and governance requirements of standalone funds.

The benefits of consolidation are:

- Cost and resource efficiencies, and
- Improved fund governance and compliance.

(This links in with the advantages of umbrella funds discussed later.)

Pension Funds Act of 1956

The primary legislation governing retirement funds in South Africa is the Pension Funds Act of 1956 (PFA). While the PFA does provides the regulatory framework applicable to all retirement funds, it does not explicitly define umbrella funds. However, "umbrella fund" will be defined in the PFA for the first time once the CoFI Bill is enacted.

In terms of the PFA, all retirement funds must appoint a board of trustees to "direct, control and oversee the operations of the fund in accordance with the applicable laws and rules of the fund".

And in terms of Section 7A of the PFA, the members of the fund have the right to elect at least half of the members of the fund board. (We usually refer to these as member elected trustees.)

It is important to note that umbrella funds are managed by a main board of trustees who take the fiduciary responsibility for the fund as a whole. However, umbrella funds are exempt from Section 7A's requirement for member elected trustees on the fund's board of trustees.

Many umbrella funds have independent professional trustees on their boards to ensure governance in decision making.

National Treasury's Discussion Paper – Governance of Umbrella Funds

In their discussion paper published in December 2021, National Treasury (NT) expressed some concerns around the governance within umbrella funds. These concerns were around employers not paying contributions, the inability of employers to switch between umbrella funds, lack of transparency on costs and fees, over-dependence on service providers for advice and the appointment of board members who are also consultants/service providers to the same fund.

In dealing with these concerns, recent discussions around retirement fund reform have included enhancements to the regulatory framework for umbrella funds. NT has started consultations aimed at improving governance structures and ensuring better protection for members.

Proposed reforms include:

- **Clear definitions**: establishing explicit definitions for umbrella funds within legislation.
- **Enhanced disclosure requirements**: Mandating sponsors to provide detailed disclosures regarding fees and services offered.

The recommendation in NT's discussion paper is that management committees be formalised and standarised, and that these manco's be given the added responsibility of establishing value for money for members.

In summary then, although the legislative framework governing umbrella funds specifically is not yet in place, this doesn't mean that there are no controls right now. Umbrella funds are governed by and must adhere to the PFA. And extending beyond that, it is important for employers to be comfortable with level of governance and compliance in place in their choice of umbrella fund. The principles and spirit of the law still applies.

Types of umbrella funds

Umbrella funds can be classified into two main types:

Type A umbrella funds

Independent management board: each employer operates a sub-fund within the umbrella fund, managed by an independent board of trustees.

Customisable special rules: each employer/sub-fund can set up their own special rules, provided they are in line with the general rules at fund level.

Flexibility: Within the parameters set by the board of trustees, sub-funds may tailor the benefits and investment strategies to suit their specific member group.

Type B umbrella funds

Uniform rules: There is one set of rules that apply to all participating employers (often linked by an industry or sector, for example, bargaining council funds).

Shared costs: costs and expenses are shared among all participating employers, leading to lower costs per member.

Limited flexibility and customisation: benefits and investment strategies are less flexible than those generally allowed in Type A umbrella funds.

The typical commercial umbrella funds in the retirement industry are Type A umbrella funds. These are set up by an insurer or administrator (known as a sponsor), and managed by a board of trustees (which usually includes independent trustees).

Advantages of umbrella funds

Cost efficiency
In the case of standalone funds, the administration and investment management services are usually outsourced to various service providers, which can prove costly for small- and medium-sized employers. These smaller employers can benefit from more resources and cost efficiencies by participating in a bigger umbrella structure with other employers, thereby spreading costs across a larger membership base. Umbrella funds typically offer lower administrative costs due to these economies of scale, and shared services and resources.

Regulatory compliance
Larger umbrella funds often have more robust governance structures and access to more resources, making it easier for employers to comply with regulatory requirements.

Enhanced governance
The presence of independent trustees on the umbrella fund's board of management helps mitigate conflicts of interest and ensures better oversight of fund management.

The possible downsides of umbrella funds

Limited flexibility on benefit and investment options
Umbrella funds generally limit the benefit and investment structures participating employers can choose from for their members. This is in an attempt to keep the options and processes simple and streamlined, to reduce complexity and cost. Participating employers will have some choices and decisions to make, but these are most typically not the full universe of options available to a stand alone fund.

Lack of member representation on the board of trustees
Exemption from having to elect member trustees leads to concerns that the interests of sponsor appointed board members may not align with members' interests. For example, the board not really having the power to terminate the services of the sponsor companies, like the administrator or the investment (or other) consultants. Engagements and interactions might not being at arm's length. And, finally, the board not being truly independent because half (or more of) the board is made up of sponsor appointed trustees.

Limited choice of service providers
Participating employers may be locked in to using the sponsor's products and service providers leading to concerns about costs that are complex and not transparent, and complacency due to a lack of competition. Most umbrella funds do limit the choice of service providers, again, to streamline processes and keep costs down.

Difficulties relating to participating employers not paying contributions
The administrator or fund may be reluctant to take action against a participating employer due to commercial reasons.

Limited influence
In a stand alone fund, the Chairman, Principal Officer and trustees are able to influence over their appointed service providers and have complete flexibility on benefit and investment options. Within an umbrella fund, the manco technically has no influence over decisions that may be reached by the fund's board. Commercially, the manco and employer can choose to move to a different umbrella fund, but this can be a complicated and frustrating process.

So what are the options available within an umbrella fund?

The specific options available in commercial umbrella funds will differ from fund to fund. Generally, however, these funds offer choices of the following.

Investments
Most commercial umbrella funds will allow participating employers the option of providing members with flexible investment choice or employer/manco choice. Within those two strategies, there will be a range of investment options suitable to different risk profiles.

Participating employers or members, in cases where investment choice is extended to them, can choose from conservative portfolios focusing on capital preservation to aggressive growth portfolios, depending on their retirement needs and goals.

Where umbrella funds do differ from each other is in the choices of investment managers or multi-managers participating employers can choose from.

All umbrella funds will comply with the default regulations insofar as these apply to investments. Participating employers will need to be comfortable that they agree with the trustees' investment defaults.

Risk benefits
Employers participating in umbrella funds can also opt for various risk (or insured) benefits such as life insurance, disability cover and funeral benefits. Most umbrella funds will offer a range of structures for these benefits – and employers will more than likely find a benefit structure that suits their members' needs.

Again, where umbrella funds do differ from each other is in the range of insurers the manco may choose from. Some funds may only offer one insurer, others may not impose any restrictions in the choice of insurer, and yet others may have a panel of approved insurers to choose from.

Communication strategies and approaches
As required by PF130, every umbrella fund will have a formal communication strategy in place. But the contents of that strategy will differ between funds. Some umbrella funds may choose to communicate only in English, others may translate their material into other languages. Some umbrella funds may provide statements quarterly, others annually. There are a range of communication events and programmes available in different umbrella funds.

Let's talk more about the role of the management committee (manco)

Many trustees and participating employers mistakenly believe that transferring into an umbrella fund absolves them of fiduciary liability and effectively they no longer need to spend any time or effort on their retirement funding arrangements.

This is not entirely true, and certainly as discussed earlier, once CoFI comes into effect, the role of the manco will be formalised.

Despite not being a formal requirement yet, employers are encouraged to set up manco's to actively oversee their participation in their umbrella funds. These committees play a vital role in ensuring that members' interests are represented and that appropriate risk benefits are obtained.

Responsibilities of the manco:

- Monitor that monthly contributions and supporting schedules are receipted in line with legislative requirements.
- Compliance with regulations – for example, that all eligible employees are on the fund.
- Overseeing fund performance and ensuring alignment with organisational goals.
- Communication with members – make sure that the communication material from the fund reaches members. And making sure that members are educated around their benefits and options within the fund.
- Death claims – the employer is much better placed, having worked with the deceased, to be able to investigate the late member's dependants and nominees.
- Engaging with service providers to negotiate favourable terms, including the umbrella fund itself. The FSCA has highlighted a concern that many commercial umbrella funds have inherent conflicts of interests. The sponsor is often also the major service provider and often provides multiple services (administration, risk benefits, investments and consulting). The sponsor cannot avoid these conflicts, and the employer needs to be the one protecting members from any possible abuse by the sponsor.

Conclusion

Umbrella funds represent a vital part of South Africa's retirement savings ecosystem, providing numerous benefits such as cost efficiency, improved governance, and flexible investment options. However, ongoing reforms aim to address existing challenges related to transparency, conflicts of interest, and compliance. As South Africa transitions towards new regulatory frameworks, all stakeholders must make sure that these structures serve the best interests of all participants involved.

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For an on-line version of the required reading material as well as electronic CPD Submission form, go to https://www.pensionsworldsa.co.za or https://www.ebnet.co.za

How to?

Answer all the questions by inserting the correct answer(s) into the block provided next to each question, scan the pages and email to Toni Cantin at ICTS, using cpd@icts.co.za

1. A standalone fund is a fund which:

a. Is made up of a number of unrelated participating employers
b. Has a set of overarching general rules and a set of special rules for each employer
c. Is set up for an employer for only their employees, with it's own set of registered rules
d. Generally has an exemption from having member trustees

2. An umbrella fund is a fund which:

a. Is made up of a number of unrelated participating employers
b. Has a set of overarching general rules and a set of special rules for each employer
c. Generally has an exemption from having member trustees
d. All of the above

3. Umbrella funds are generally cheaper because they take advantage of economies of scale.

a. True
b. False

4. Choose the <u>incorrect</u> answer. A management committee in a commercial umbrella fund, is generally able to choose the following:

a. The board of trustees
b. Their death benefits
c. Their contribution rates
d. The dates of the manco meetings

5. In their discussion paper published in December 2021, National Treasury (NT) expressed some concerns around the governance within umbrella funds. These concerns were primarily around:

a. Employers not paying contributions
b. Lack of transparency on costs and fees
c. Over dependence on service providers
d. All of the above

6. A type A umbrella fund has:

a. Uniform rules
b. Customisable special rules
c. A link to an industry or sector
d. All of the above

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7. The advantages of an umbrella fund are:

a. Cost efficiencies ☐
b. Regulatory compliance ☐
c. Enhanced governance ☐
d. All of the above. ☐

8. The disadvantages of an umbrella fund are:

a. They are not popular, so no precedent has been set ☐
b. The FSCA does not regulate them ☐
c. They have limited choices of benefits and investment options. ☐
d. The Pension Funds Act makes no provision for them ☐

9. The responsibilities of the management committee include:

a. Monitoring that monthly contributions and supporting schedules are receipted in line with legislative requirements. ☐
b. Overseeing fund performance and ensuring alignment with organisational goals. ☐
c. making sure that the communication material from the fund reaches members. ☐
d. All of the above ☐

10. The role of the management committee will be formalised in the Pension Funds Amendment Act.

a. True ☐
b. False ☐