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NATIONAL TREASURY'S DISCUSSION PAPERS – DECEMBER 2021 - GOVERNANCE OF UMBRELLA FUNDS

UMBRELLA FUND GOVERNANCE

This Paper addresses issues that relate to umbrella funds, stand-alone funds, sponsors, employers and members. National Treasury states that while some umbrella funds (multi-employer funds) appear to be well run, it is concerned about the governance of others and the effect that poor governance has on member outcomes.

Governance challenges of umbrella funds, according to Treasury, include:

- Over-dependance of board members on product and service providers for advice;
- Conflicts of board members between loyalties to members and those who elected or appointed them;
- Rules of funds that tie funds to specific service providers or compel members to remain enrolled when members or employers believe there is better value for money elsewhere.

Thus, National Treasury will embark on a consultation process with industry, labour unions and interested stakeholders on measures to improve governance.

COMMERCIAL RETIREMENT FUNDS

The Paper states that particular attention will be paid to colloquially called *commercial umbrella funds* during this process. Treasury states that *commercial retirement funds* are those that have been established by financial services providers to drive new business to themselves and related parties and are operated as if they are parts of the businesses of those for-profit organisations.

CONCERNS WITH UMBRELLA FUND GOVERNANCE

Treasury notes that multi- employer funds can offer cost advantages allowing small employers to achieve economies of scale they would not otherwise have been able to enjoy in a small occupational fund. However, Treasury also notes several disadvantages of multi-employer funds, such as:

- lack of member representation on the board of management, leading to concerns that the interests of sponsor-appointed board members do not align with members' interests, for example, the board not really having the power to fire the sponsor companies, engagements not being at arm's length and the board not being truly independent because half the board is made up of sponsor appointed trustees;
- locking in of the fund to the sponsor's products and services leads to concerns about excessive costs that are complex and opaque and inadequate services (due to lack of competition); and
- difficulties related to participating employers not paying contributions where the administrator or fund for commercial reasons may not want to take action against the participating employer.

INTERNATIONAL EXPERIENCE AND INDEPENDENT GOVERNANCE COMMITTEES

National Treasury has considered international experience in relation to multi-employer, commercial and other funds. In particular, it expands on the Master Trust market in the United Kingdom.

National Treasury recognises the practical difficulties of umbrella funds having employers and employees nominating and electing board members.

Within the workplace personal pension scheme space in the UK, pension schemes are required to set up and maintain independent governance committees ("IGCs"). National Treasury notes that IGCs are like independent trustees, appointed by the providers and have oversight of the multi-employer scheme. They have a fiduciary duty and are given clear duties and powers to act in the interests of members. They also undertake the value for money assessment of the pension scheme.

National Treasury likens umbrella fund management committees (sometimes called joint forums or advisory committees) to IGCs. In South Africa, management committees are not recognized in legislation but National Treasury recognizes that they perform functions such as: updates to member data, ensuring that contributions are paid over to the fund, processing death benefits with the fund, providing updates to members of the fund and recommending amendments to benefit structures.

National Treasury states that these 'quasi-boards' could be fomalised and standardised in South Africa and given an added responsibility of establishing value for money for members. It further states that value for money measurement criteria and tools should be established and a Conduct Standard published in which funds that are unable to demonstrate that they comply – or within a defined period will comply – with specified 'value for money' standards will be required to procure the transfer of their assets and liabilities to other funds that do comply with the criteria and then the fund will need to deregister.

POLICY MEASURES

National Treasury states that it is still of the view that most employers will only be able to achieve suitable economies of scale by joining multi-employer funds of some form. Given the concerns specified above regarding governance, Government must come up with policy options to strengthen the governance of umbrella funds, that employers are made active purchasers of retirement funds and that competition is increased in the market.

The Financial Sector Conduct Authority ("FSCA") is already working on measures to improve the governance of funds that are exempted from giving members the right to elect 50% of board members (or from having four board members) ("exempted funds"), including making King IV compulsory for funds and have already issued Guidance Note 4 of 2018.

The FSCA is looking to introduce the following additional measures:

- board members, including independent board members should not be on more than three boards in any year, including membership of company boards; and
- independent board members should not be contracted as consultants/service providers to the same fund of which they are board members.

EMPLOYER RELATED STRUCTURAL SOLUTIONS

Employers can use their discretion to provide retirement solutions and also whether to provide this through occupational funds or commercial umbrella funds.

Treasury states that it supports an auction system conducted under the FSCA to enable stand-alone funds to select and appoint default 'consolidation' or auto-enrolment funds when they need it. The idea seems to be that providers of umbrella funds would be required to bid for the right to enroll new members of the umbrella fund, which members then remain captive for a period (for example two years). Bids must cover administration costs, internal investment costs and must be lower than the minimum fee currently available in the market.

In addition, services provided to an umbrella fund should also be subject to an open bid process, with the sponsor being one of the tenderers. This means that the use of the sponsor's services cannot be compulsory.

Treasury suggests that the auction mechanism could form part of the South African system and could, for example, work as follows:

- a central auction system could be set up for boards of small funds that don't meet value for money criteria. The board could request boards of existing funds to take over their retirement scheme;
- only pension schemes meeting strict criteria could bid for these closing funds (could be 'blind') on a standardised basis;
- or, the FSCA should establish a regular auction between umbrella funds bidding to become the default consolidation fund for a set period;

Treasury notes that the auction system could also be used to identify the default provider under any auto-enrolment system.

OTHER MEASURES

National Treasury is considering introducing:

- measures to increase the disclosure of costs and charges;
- template rules for retirement funds;
- prohibiting lock-in provisions (of sponsor products and services) in rules and agreements; and
- sponsors to compete for business of providing products and services of exempted funds.