



Legal update 1 of 2022: Government's reform proposals on the governance of umbrella funds

Introduction

On 14 December 2021, National Treasury issued a discussion document on the governance of retirement funds in general and, in particular, the governance of commercial umbrella funds like the FundsAtWork Umbrella Funds (the FAW Funds).

While some commercial umbrella funds appear to be well run, National Treasury is concerned about the potential consequences of poor governance in certain funds. The intention is therefore to make proposals on how the governance of commercial umbrella funds can be strengthened.

This legal update reviews some of the most noteworthy concerns and proposals made by National Treasury. In principle, the FAW Funds support most of National Treasury's proposals.

The role of the sponsor in commercial umbrella funds

Most of the board members of commercial umbrella funds in South Africa are typically appointed directly or indirectly by the fund's sponsor. In line with this practice, all seven board members of the FAW Funds, of which at least four are independent board members, are appointed by Momentum - the FAW Funds' sponsor. These appointments are made according to the procedure and requirements set out in the FAW Funds' Procedure Document for the Appointment of Board Members.

National Treasury believes that the lack of member representation on umbrella funds' boards of management means that the interests of the board members appointed by the sponsor may not align fully with the interests of members, resulting in conflicting loyalties to members and to the sponsor. National Treasury is also concerned that when a fund's service providers are affiliated with the fund's sponsor, it has the potential to lead to undue influence on the board to select a particular service provider.

Although most of FAW Funds' service providers are affiliated with Momentum, we can confirm that the FAW Funds' board manages and records the tender and appointment process for service providers in such a way that any potential and/or perceived undue influence on the board to select a particular service provider, is mitigated. The purpose of the FAW Funds' Procurement Policy is to ensure consistent adherence to ethical and professional procurement practices; and ensure that the tender and appointment procedure of all the FAW Funds' service providers is fair, equitable, transparent and not anti-competitive.

National Treasury is proposing that independent board members should not be contracted as consultants or service providers to the same fund of which they are board members. We can confirm that in terms of the FAW Funds' Procedure Document for the Appointment of Board Members, candidates for the position of independent board member cannot be employed by, or receive any income from, or be controlled by, or be subject to the authority of Momentum, or any other service provider of the FAW Funds.

National Treasury believes that sponsors establish commercial umbrella funds on the basis that the services provided by the sponsor will be used exclusively by the fund, resulting in the board of such a fund not being truly independent because it is limited when appointing service providers. The concern is a potential lack of competition then leads to excessive costs and/or inadequate services. National Treasury therefore proposes that provisions resulting in the 'locking-in' of umbrella funds to services provided by the sponsor, where the board is unable to terminate the appointment of a specific service provider related to the sponsor, should not be allowed in the rules or agreements with service providers.

We confirm that there are no lock-in provisions in the rules of the FAW Funds or in service provider agreements entered into with the FAW Funds.

Employer advisory (management) bodies

While National Treasury recognises that member representation in commercial umbrella funds is important, it also recognises the difficulty of employer and employee nomination and election to the board of a commercial umbrella fund. To address this, as well as the perceived undue influence a sponsor may have in a commercial umbrella fund, National Treasury proposes that employer advisory/management committees are formalised and standardised for employers in umbrella funds.

The appointment of an advisory body for each employer on the FAW Funds is already a requirement in terms of the rules of the FAW Funds, irrespective of the number of members on the scheme.

National Treasury also proposes that these employer advisory bodies have the following minimum standardised functions, in addition to those delegated by the fund's board to them.

1. Conducting assessments as to whether the commercial umbrella fund is providing ongoing 'value for money' for the employer's scheme. What is important here is that although decisions to change the scheme or elements within it rest with the employer (through its advisory body), it remains the responsibility of the fund's board to address poor value as far as the board is able, and it's important that the board can work effectively with employers in this regard.

It is proposed that 'value for money' measurement criteria and tools to conduct this assessment are prescribed in a conduct standard. The areas that could be included are:

- what the scheme provides for members and at what cost, i.e. are the benefits provided by the fund suitable for, relevant to and valued by members,
- whether the scope and quality of each service provides good value for the costs and charges incurred by members, and
- whether the scope and/or quality of a particular service justifies any differences in cost when compared to similar schemes and other options available in the market.

2. Assisting the fund with information/updates to member data.
3. Ensuring that contributions are paid over to the fund.
4. Processing death benefits with the fund. It is unclear at this stage what "process" would mean and the FAW Funds has asked National Treasury for clarity.
5. Providing updates to members on fund benefit structures.
6. Recommending amendments to the benefit structures of the employer's scheme.

Barriers to transfers to other funds

Some umbrella fund rules compel employers to remain participating in the fund even if they and the members are convinced that it's performing poorly and better value for money is available elsewhere. The FAW Funds support National Treasury's proposal that an employer should not be prohibited from transferring to another fund and that such a transfer should be at a low cost. We confirm that the rules of the FAW Funds do not contain barriers like this and that the FAW Funds do not levy a transfer fee.

Standardised disclosure of costs

Currently, the structure of costs and charges across all retirement funds is not standardised, making it difficult for employers to compare what the service providers of the different commercial umbrella funds charge. FAW Funds agree with National Treasury that members and their participating employers need to be empowered to properly evaluate whether they are getting value for money from the fund they participate in. FAW Funds therefore support the proposal that all funds (including stand-alone funds) must provide information in a standardised way to enable comparison between funds and to promote effective competition in the case of commercial umbrella funds. This will mean it's possible for participating employers to compare the different umbrella offerings which would in turn lead to better outcomes for both employers and members.