Governance of umbrella funds

Executive summary

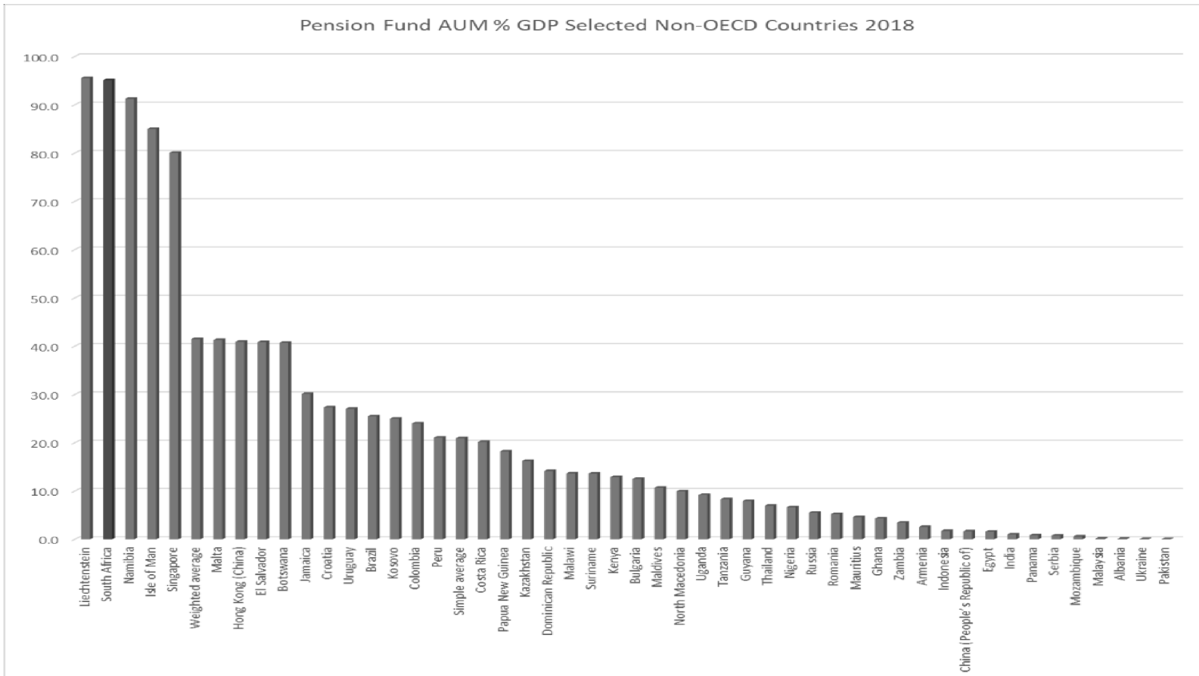
It is often not economical for every small employer to have their own retirement fund for their employees. Rather, small employers and their employees should benefit by joining multi-employer funds of one kind or another. To do so, they will need to be confident that the interests of members, who in most cases will have been enrolled into these funds as a condition of employment, are well looked after and protected. While some multi-employer funds appear to be well run, the National Treasury is concerned about the governance of others and the consequences of poor governance on member outcomes. Some of the governance challenges include the over-dependence of board members on product and service providers for advice and conflicts between loyalties to members and to those who elected or appointed the board members. The rules of some funds also constitute an impediment to sound fund governance, management, and administration because they tie the funds to specific service providers. Some rules even compel members to remain enrolled in those funds when they, and their employers, are convinced that better value for money could be obtained elsewhere.

In response to these problems, the National Treasury would like to initiate a consultation process with industry, labour unions and interested stakeholders on measures to improve the governance of these funds to further protect the interests of members who are enrolled in them. Particular attention will be paid to commercial umbrella funds as part of this process.

Introduction

The retirement funds sector in South Africa is highly developed. Total retirement funds assets amount to close to 100% of GDP, which is one of the highest in non-OECD countries and is also large by standards of more developed economies (see Figure 1).

Figure 1: Pension fund assets % of GDP



Source 1: OECD

Approximately two-thirds of formal sector employees belong to a retirement fund,[1] which makes South Africa's rate of occupational retirement funding coverage of formal sector employees amongst the highest in the world.[2] The total industry assets amount to about R3.8 trillion, with 489 commercial umbrella funds in 2019 accounting for R1.07 trillion of these industry assets under management (see Table 2 below).

South Africa has a relatively well-developed retirement fund[3] market that is based on the 'Anglo-American' model[4] with significant adaptations.[5] Membership of these funds is promoted

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1 11 million out of 16.4 employed https://www.gov.za/speeches/quarterly-labour-11-feb-2020-0000

2 See https://www.gov.za/sites/www.gov.za/files/Comprehensive_Social_Security_in_South_Africa_a.pdf at para 2.6. See also paragraph 3.7 of the 'green paper' published by the Department of Social Development in *Government Gazette* 45006 on 18 August 2021, a copy of which may be obtained from the website of the Government Printer at Government Printing Works (gpwonline.co.za) under '**45006 18-8 SocDev**'. The paper was withdrawn by the DSD on 1 September 2021. See Department of Social Development - Latest News (dsd.gov.za)

3 Pension funds, provident funds, retirement annuity funds, beneficiary funds and unclaimed benefit funds all fall within the scope of the term 'pension fund' as defined in the PFA. All these funds will in the near future be replaced by the term 'retirement fund' and so, in this document, a reference to a 'retirement fund' or 'fund' includes a reference to any of these kinds.

4 According to World Bank analysis, key features of this model include the following:

- Employers are permitted, but not required by law, to establish retirement funds;
- These funds take the form of not-for-profit trusts governed by trustees as agents for the members; and
- Conditions for registration of new funds are minimal with the result that too many funds are established making it difficult for the supervisor to supervise them effectively. Reliance is placed on the supervision of financial services and professionals involved in the funds and on disclosures to members. Supervision is reactive, remedial and punitive rather than interactive and preventative.

See Regulation and Supervision of Pension Funds (worldbank.org).

5 Retirement funds subject to regulation and supervision in terms of the Pension Funds Act, 1956 (the PFA) are legal entities with their own interests and which act as principals, rather than as agents for their members. Retirement funds not subject to the PFA are established as legal entities in terms of special purpose legislation.

by the state through generous tax incentives[6] at a considerable cost to the fiscus[7]. As such retirement funds are vehicles through which the state provides for the progressive realisation of the right to social security in compliance with its constitutional obligations. This alone justifies reasonable interventions in the way the businesses of retirement funds are conducted with a view to ensure they provide value for money to their members.

There are various kinds of retirement funds recognised in South African law. These include occupational retirement funds (i.e. both stand-alone and multi-employer or umbrella funds such as bargaining council funds, sectoral funds, trade union funds and commercial umbrella funds), voluntary funds, including retirement annuity funds and preservation funds, most of which are 'commercial' funds in that they have been established by for-profit financial services entities with a view to driving new business to themselves and/or related entities.

As is common in jurisdictions that have adopted the 'Anglo-American' model, in which the barriers to entry to the retirement funds market are low, South Africa has too many registered retirement funds to allow for economies of scale and value for money benefits.[8]

While South Africa still has too many registered retirement funds, the number of active funds (that is, funds in regular receipt of contributions and/or regularly paying benefits to members) has substantially reduced over the course of the last thirty years.

In the 1980s, and in the context of a substantial rise in the influence of trade unions over the working conditions of their members, several collective agreements were concluded in terms of which union members were enrolled in new, defined contribution, multi-employer funds established by or at the initiative of those unions.[9] Nonetheless, as of December 2000 there were 15 587 funds registered in terms of the Pension Fund Act (PFA).

Following a hard-fought campaign by trade unions, Parliament amended the PFA to include a requirement that, unless granted exemption from compliance with this requirement, each fund was to have a board of trustees and to give its members the right to elect at least 50% of the members of its board. This change, which came into effect in 1996, appears to have accelerated the shift by employers from stand-alone to multi-employer or umbrella pension

[6] In the form of allowable deductions of contributions to retirement funds from taxable income of up to R350 000 per year, tax-free returns earned by retirement funds on the investment of their assets and the generous tax treatment of benefits paid by retirement funds.

[7] In the financial year ended February 2019, 'tax expenditure' in the form of revenue foregone as a result of the exclusion of retirement funding contributions from taxpayer income alone cost the fiscus some R87 billion. See p1 of annexure B to National Treasury's 2021 *Budget Review* a copy of which may be found at Microsoft Word - 20210208 Annexure BV4 (treasury.gov.za)

[8] See National Treasury's July 2013 discussion paper *Charges in South African retirement funds* at page 12. A copy of the paper may be found at www.treasury.gov.za

[9] Andrew, J. *Conversion from Defined Benefits to Defined Contribution – The South African Experience*, a paper which may be found on the website of the UK Actuarial Society at www.actuaries.org.uk, at p3-4.

funds[10] and as at 31 March 2020, there were 5 124 (31 March 2019: 5 140) registered retirement funds in South Africa of which 1 452 (31 March 2019: 1 528) funds are active.

The Financial Sector Conduct Authority's (FSCA) integrated annual report for the year ended 31 March 2020 provides the following interesting statistics:[11]

Table 1

RETIREMENT FUNDS: FINANCIAL YEAR ENDING 31 DECEMBER 2018						
Financial year ending	**2016**	**Change %**	**2017**	**Change %**	**2018**	**Change %**
Number of funds	5 144	(0.0)	5 158	0.3	5 124	(0.7)
Membership ('000)	16 644	1.2	16 946	1.8	17 522	3.4
Contributions (R'm)	227 024	6.6	238 520	5.1	255 902	7.3
Benefits paid (R'm)	325 918	13.6	314 603	(3.5)	358 042	13.8
Assets (R'm)	4 146 048	2.7	4 262 395	2.8	4 490 617	5.4

Retirement funds: Number of funds by administrator at 31 March 2020

Administrator	Active funds*	Other funds	Total funds
Liberty Group	107	992	1 099
MMI Group	52	747	799
Alexander Forbes Financial Services	2 695	480	745
Sanlam Life Insurance	112	228	340
Absa Consultants and Actuaries	118	171	289
Old Mutual Life Assurance Company (South Africa)	22	169	184
NBC Fund Administration Services	74	59	133

There are already numerous multi-employer funds (see table below) (or what are known in South Africa as 'umbrella funds') in operation. Most of these umbrella funds 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. These funds are colloquially, and in this paper, referred to as commercial retirement funds.

Table 2: Number of umbrella funds

Year	No. of umbrella funds	Total Assets	Total Members
2015	585	912 705 527 444	7 927 754
2016	567	941 324 150 083	8 180 320
2017	541	975 397 232 407	8 140 017
2018	527	1 024 760 253 134	8 820 859
2019	498	1 065 617 304 030	8 874 163
2020	449	1 025 464 621 500	8 584 931

Source: FSCA

10 Assets held by the old stand-alone funds to provide for their liabilities towards these employees were transferred to their new umbrella funds but, in many cases, assets held to provide for other liabilities, such as liabilities for unpaid benefits, and surplus assets, were not transferred with them. Probably assuming that the businesses of the old stand-alone funds had been properly dealt with, their boards ceased to operate as such and the stand-alone funds became what were known as 'orphan funds' – that is, funds without boards of trustees. (These funds should not be confused with funds established for the benefit of orphans. Those are referred to as "beneficiary funds".). This is what gave rise to the problem that the then registrar of pension funds sought to address through his 'pension funds cancellations project'. There were more than 6000 of these 'orphan funds' when the cancellations project was started in 2008.

11 See p 89 of the integrated annual report of the FSCA for the year ended 31 March 2020, a copy of which may be found at FSCA Annual Report 2019-2020.pdf.

Multi-employer funds can offer cost advantages, allowing small employers to achieve economies of scale that they would not otherwise enjoy in a small occupational fund. However, there are several potential disadvantages with umbrella funds namely:

(a) The lack of member representation on the board of management of most umbrella funds leads to concerns that the interests of the trustees appointed by the sponsor may not be properly aligned with the interests of fund members;
(b) The locking-in of umbrella funds to services provided by the sponsor leads to concerns about excessive costs and/or inadequate services due to the resultant lack of potential competition; and
(c) Difficulties arise in umbrella funds where some employers are delinquent in paying their contributions. Administrators of funds have recourse against the employer in these circumstances but may be reluctant to take such action where retaining the employer's business is a conflicting commercial interest.

Competition is potentially provided by the ability of employers to move between umbrella funds in a relatively low-cost way (consistent with the portability principles). However, the power of inertia is such that it is preferable from a policy perspective to try and address the sources of potential conflicts of interest and high costs in umbrella funds.

Key challenges

In 2014, the National Treasury announced its policy intention to encourage consolidation of funds: to reduce the number of funds to enhance economies of scale and pass these benefits to members. However, it seems this policy proposal has nudged industry to start the consolidation process albeit, skewed towards consolidation in commercial umbrella funds. Though the consolidation that had ensued seemed favourable towards umbrella funds, the number of umbrella funds has declined steadily since 2015, however, the number of members in these funds has been increasing up to 2018 and then started declining after that.

Umbrella funds are largely grouped into type A and type B umbrella funds. Type-A umbrella funds are commercial umbrella funds, which require main and special rules and provisions specific to each participating employer, which regulates, *inter alia,* contribution rates, eligibility conditions, retirement ages and risk benefits (if any). Any employer may participate in such a fund.

Type-B umbrella funds only have main rules; the rules have equal application to all employers. These are usually industry/sector-specific funds with the result that only employers who participate in the industry/sector may or must participate in a particular fund, for example, Bargaining Council funds.

There is no definition of an umbrella fund in the current legislation. The COFI Bill provides for a definition of umbrella funds and would further split them into Type A and Type B umbrella funds. Type B umbrella funds have rules that provide for the number of trustees that may be appointed. Generally, it provides for at least 50% member-elected trustees with the other 50% or balance comprising employer nominated trustees and sometimes the rules also provide for the appointment of an independent trustee. Where a trade union establishes the fund (also referred to as a type B umbrella fund), the rules generally provide that the member representatives comprise most of the board.

Every fund is by law required to have at least 50% of the board member representation elected by the members of the fund. However, funds established for the benefit of employees of different employers (i.e. umbrella funds); retirement annuity funds, beneficiary funds or preservation funds; may be exempted from the requirement that the members of the fund have the right to elect members of the board (see section 7B of the Pension Funds Act, 24 of 1956 ("the Act"). It is the recommendation of the FSCA for purposes of good governance that funds which are granted exemption in terms of section 7B of the Act should at least have 50% independent trustees on the board (see Guidance Notice 4 of 2018).

Member representation in commercial umbrella funds is important, especially in the era of defined contribution (DC) funds, because members bear the investment risk in these funds. In the US, some multi-employer schemes have an equal employer and employee representation on the boards[12]. For commercial umbrella funds in SA, other than the independent board members, most of the trustees in commercial umbrella funds are typically appointed directly or indirectly by fund sponsors. This raises the possibility of conflicts of interest between boards and members[13].

Weak governance

National Treasury is of the view that concerns arise when service providers are affiliated with the commercial umbrella fund sponsor. This has the potential to lead to undue influence on trustees to select a particular service provider and conflict of interest may arise due to indirect benefits flowing to trustees from a mutually beneficial relationship between service providers and sponsors.

Some of the problems in the conduct of the businesses of some (but not necessarily all) umbrella retirement funds have been canvassed in National Treasury's 2013 technical

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[12] Mercer, 2015, Governance of superannuation funds: A report on independence requirements for trustee boards, p 16 May.

[13] National Treasury, (2013) Charges in South African retirement funds

discussion paper "*Charges in South African retirement funds*".[14] Some of the identified problems included the following:

- The sponsor establishes the fund on the basis that the services provided by the sponsor will be used exclusively by the fund. The trustees have generally no power to fire the service providers, the terms of engagement of which (including their charges) are not negotiated at arm's length because the board is not truly independent and is also not at liberty to choose a different service provider. It seems there has recently been a shift from a one-stop-shop approach of in-house service providers.

- The board of such a fund is not truly independent both because it has limitations in respect of the service providers used and because at least half the board comprises sponsor appointed trustees who are in the employment of the sponsor. It is very difficult to expect an employee of the sponsor to act as a truly independent trustee if the consequence of that would be career limiting.

Complex and opaque charges

Though not unique to commercial umbrella funds, the structure of charges is not standardised across all retirement products, making it difficult to compare what different providers charge. Disclosure of the costs by both providers of financial products and services to their clients and by retirement funds to their members and participating employers is generally poor and is not required to be done in a way that facilitates comparison and competition.

Although the Association for Savings and Investments South Africa (ASISA) has established a retirement savings costs disclosure standard required to be used by its members in disclosing costs to retirement funds from 2019, the standard is currently only applicable to ASISA members. ASISA has also established an 'effective annual cost' disclosure standard to be used in disclosing to fund members, costs associated with financial products in which their retirement savings may be invested.

While the voluntary adoption of these standards by sponsors of large commercial umbrella funds is salutary, it is not sufficient to empower the fund members and their participating employers to properly evaluate whether they are deriving value for money from the retirement funds. Value for money is utility derived from the money spent on something – commercial umbrella funds in this case. The standards are also not applicable to other umbrella funds that are not members of ASISA. National Treasury is of the view that better disclosure alone is unlikely to be sufficient on its own to achieve lower costs.

[14] National Treasury, *Charges in South African retirement funds* discussion paper op.cit at footnote 8.

Barriers to entry/switching

Barriers to entry and switching may exist at the level of the provider (i.e. potential umbrella fund providers) or at the level of the participating employer. Potential umbrella fund providers may face barriers to entry due to the high proportion of up-front costs in setting up an umbrella fund.

Similarly, participating employers may be discouraged from switching between umbrella funds by barriers, such as fund rules that prohibit an employer from exiting the fund. Other barriers might include unwillingness to spend the time and effort research for other cost-effective umbrella fund providers, resulting in inertia and the failure to switch out of poorly performing plans. Also, employees who are enrolled into umbrella funds that are selected by their employer may not have the option of switching providers.

International experience

The OECD[15] (2008:5) noted the following positive things about good governance:

a) Good governance can have many positive effects such as creating trust amongst all stakeholders, reducing the need for prescriptive regulation, and facilitating supervision.
b) Good pension fund governance can also be conducive to more effective corporate governance of the companies that they invest in, as well-managed pension funds are more likely to seek value for their investments via a more active shareholder policy.
c) Good governance also needs to be risk-based. For example, the more sophisticated the investment strategy the pension fund adopts, the stricter the governance oversight required; or the more complex the administrative arrangements of the plan, the tighter operational oversight needs to be.

The OECD[16] also states that the governing body of a fund set up in the contractual form (like an umbrella fund) is usually the board of directors of the management entity, though in some countries (e.g. Spain) some key responsibilities are shared with a separate oversight committee (*comisión de control)* where the committee has responsibilities akin to a typical governing body.

In improving governance of DC and commercial multi-employer funds, the OECD[17] proposes:

- The establishment of an independent management committee or similar governance body (e.g. union, employee representatives, staff forum) whose function is to review

[15] OECD, 2008, Pension fund governance: challenges and potential solutions, p 5.
[16] OECD, 2008, Pension fund governance: challenges and potential solutions, p 6.
[17] OECD, 2008, Pension fund governance: challenges and potential solutions, p 28.

how the contract-based scheme is working (e.g. looking at administration, investment choices, member communications etc.).

- Strengthening the role of pension fund supervisory authority in monitoring private pension providers.

Master Trust Market in the UK

The UK has Master Trust schemes, which are similar to umbrella funds but have to meet specific operational requirements to operate. The Master Trust concept is discussed here to allow for South Africa to assess its applicability for its environment to address low-cost services and coverage.

A Master Trust is an occupational pension scheme that provides retirement benefits and is used or intended to be used, by two or more employers. Master Trusts offer workplace pensions to groups of employers that are not connected and are run by a trustee board.[18]

Before the pension reform in the UK, many medium and large-sized companies had their own pension plans; industry-wide schemes were not common, although there were some multi-employer schemes. At the time these were normally defined benefit (DB) schemes, to which both the employer and the employees contributed, and which paid a pension based on a proportion of earnings (normally final earnings) linked to the number of years of service with that employer.

Under the Pensions Act 2008, auto-enrolment (AE) was introduced, beginning with the largest companies[19]. Under AE, the employer enrols all employees in a workplace pension scheme, to which the employer must make a minimum contribution; employees have the option of opting out of the scheme. The introduction of auto-enrolment was phased in over a period that ended in 2019. The government introduced auto-enrolment to ensure that all eligible employees are offered the opportunity of being members of a workplace pension scheme – including lower-income workers who were frequently excluded.

Since AE was introduced, growth in the Master Trust market has far exceeded expectations. Around 10 million people are newly saving or saving more because of AE into workplace pensions – taking private pension coverage rates up from around 47% of the labour force before auto-enrolment was introduced in 2012 to over 77% in 2019.

Since employers who are responsible for AE preferred DC over DB for reasons of the cost burden, the increase in pensions through AE led to an increase in DC Trust markets. According to the latest figures, over 90% of eligible jobholders automatically enrolled into an

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18 Pension Schemes Act 2017, s1.

19 Pensions Act 2008, s3

occupational DC scheme were enrolled into a Master Trust Scheme. The number of pension pots invested in multi-employer trust-based schemes (Master Trusts) increased from 270,000 in 2012 to over 18.6 million in 2020.[20]

Despite the overall growth of the Master Trust market, some schemes were poorly run and unlikely to achieve sufficient scale to cover costs. There were insufficient controls in the Master Trust market, with a voluntary framework allowing well-run schemes to gain independent assurance of quality standards. However, there were no legal requirements to achieve specified standards before operating in the market. Given that AE introduced a 'quasi-mandate' to save, it was felt necessary to improve the governance and overall management of the Master Trust schemes.

Master Trust Regulations

In the UK, the Pension Schemes Act (PSA) 2017 became a backbone of the legislation of Master Trusts. The PSA 2017 introduced the powers for an authorisation and supervision regime for Master Trust pension schemes. A couple of measures were introduced upon Royal Assent and backdated to October 2016, when the Bill was introduced. Schemes were required to notify the Regulator if they experienced a triggering event (events that would put the scheme at risk of needing to wind up) and charges were capped at October 2016 rates. These measures provided some protection for members prior to the full regime coming into force.

The authorisation criteria

The criteria for authorisation consists of:

- persons who operate Master Schemes (***Fitness and propriety);***
- stable and effective system (***System and process***);
- the strategy to deal with critical problems (***Continuity strategy***);
- ensuring independence/ transparency (***Scheme funder***); and
- financial soundness (***Financial sustainability***).

<u>Fitness and propriety:</u>

The first authorisation criterion requires the persons involved in a Master Trust scheme (including the scheme trustees and scheme funder and scheme strategist to be 'fit and proper' persons.[21]All individuals being assessed must be able to satisfy the Pension Regulator (TPR) that they are fit and proper because they meet the standard of honesty, integrity and knowledge appropriate to their role.

20 <u>TPR: DC trust scheme return data 2010 - 2021</u> (31 Dec. 2020).
21 <u>PSA 2017, s7</u>

System and processes:

The systems and processes of the Master Trust scheme must be sufficient to ensure that the trust is run effectively. The matters which the Pensions Regulator must consider in making this assessment are set out in Schedule 4 of the subordinate regulations. These matters include looking at the Master Trust scheme's IT systems, record management, risk management, resource planning, processes relating to transactions and investment decisions, processes relating to the appointment and removal of trustees, their roles and responsibilities.[22]

Continuity strategy:

The Master Trust scheme must have an adequate continuity strategy, i.e. a document addressing how the interests of member are to be protected if certain types of events occur.[23] These events are referred to as 'triggering events'.

Scheme funder:

Each 'scheme funder' must be a separate legal entity that carries out only activities relating to the Master Trust scheme.[24] This is to ensure that the financial arrangements between the scheme funder and the Master Trust scheme are sufficiently visible for the Pensions Regulator's financial assessment. A 'scheme funder' is a person who is required to fund the scheme if administration charges received from, or in respect of, members do not cover the scheme's running costs, or a person who is entitled to receive profits if charges exceed running costs. There is no express legal requirement for a Master Trust scheme to have a scheme funder. Schemes without a scheme funder will need to satisfy the Pensions Regulator that they have, or have access to, sufficient financial resources to be financially sustainable.

Financial stability:

The Master Trust scheme must be financially sustainable (i.e. the business strategy relating to the scheme must be sound and the scheme must have sufficient financial resources to meet the scheme's set-up costs, running costs and the costs of resolving a triggering event) and must have an 'approved business plan'.[25]

An approved business plan is a business plan prepared and kept up-to-date by a 'scheme strategist', i.e. by the person responsible for making business decisions relating to the commercial activities of the scheme. The government intends that the latter phrase should be interpreted broadly so that even if a scheme does not intend to make a profit or operates in a specific industry only, it must still offer an attractive proposition to its employers and members

[22] PSA 2017, s11 Master Trusts Regulation 2018, Sch4
[23] PSA 2017, s12 Master Trusts Regulation 2018, reg 11 - 12
[24] PSA 2017, s10
[25] PSA 2017, s8 - s9 Master Trusts regulation 2018, reg 6 - reg7, sch2 - sch3

within the wider commercial market in which it operates and thus, must have a scheme strategist.

The authorisation process

An application (which must be submitted by the trustees) will first be assessed by an authorisation team who will then issue a preliminary recommendation letter to the decision-maker and the Master Trust. If the authorisation team recommends authorisation and the decision-maker agrees, authorisation will be granted. If the authorisation team (or the decision-maker) is not persuaded that the Master Trust meets the authorisation criteria, then unless the Master Trust chooses to withdraw its application, a decision meeting will be scheduled. Before that meeting takes place, the Master Trust will be given time (one or two weeks) to make written submissions, to which the authorisation team will have to respond within another one or two weeks.

While authorisation decisions made in respect of existing Master Trusts were made by the Pensions Regulator's Determinations Panel, decisions in respect of new Master Trusts are made by the executive arm of the Pensions Regulator. This reflects the higher degree of scrutiny that was required in respect of existing Master Trusts.

In the case of the existing scheme, the application period of 6 months after the enforcement of the law was given and the operation was normal during that period, minimising the confusion caused by the introduction of new regulations. TPR also minimized unnecessary confusion and expectations by clearly announcing what actions would be taken if authorisation was not granted for a 6-month period.

Ongoing supervision

The Pensions Regulator supervises Master Trust schemes on an ongoing basis. It can and will do so by obtaining the following information from Master Trust schemes:

- the trustees and scheme funder of a Master Trust scheme must each send their accounts to the Pensions Regulator every year.
- trustees are required to submit a 'supervisory return' (normally alongside an annual scheme return) to the Pensions Regulator, providing updates against the authorisation criteria. Trustees will receive at least six weeks' notice to submit this return. The type of information that may be requested through a supervisory return is set out in the subordinate regulations.
- trustees, scheme funders, scheme advisers and other persons are all placed under a duty to notify (i.e. whistle-blow to) the Pensions Regulator on the occurrence of certain 'significant events'. The subordinate regulations specify what events constitute significant events. This includes:

- a person running the scheme being convicted of an offence or entering into bankruptcy;
- a significant change to the statement of investment principles;
- a significant change that requires a revision of the business plan;
- the scheme is unable or unlikely to meet its liabilities on demand.

The Pensions Regulator also has powers to impose fixed penalties (and escalate any penalty notice) if a person fails to provide the information requested by the Pensions.

Triggering events and continuity options

Triggering events are effectively events that might suggest the Master Trust scheme is failing. The triggering events are listed in Pension Schemes Acts 2017 and include the following:

- notification from the Pensions Regulator that the Master Trust scheme is not authorised;
- the Pensions Regulator issues a warning notice in respect of a decision to withdraw a Master Trust scheme's authorisation;
- an insolvency event occurs in relation to the scheme funder or the scheme funder is unlikely to continue as a going concern;
- the scheme funder decides to terminate the Master Trust scheme; and
- the trustees decide that the Master Trust scheme is at risk of failure so that it becomes necessary to pursue a continuity option.

TPR has produced material to help identify triggering events, including a table setting out the triggering events that need to be reported, the date the event is treated as having occurred and who is responsible for reporting it, as well as guidance entitled 'Identifying and reporting triggering events'.[26]

Value for Members (VFM): Independent Governance Committees (IGCs)[27]

The UK Government introduced pension automatic enrolment in 2012. This meant that many employers who did not already provide their staff with a pension scheme were legally required to enrol eligible employees and make payments into a suitable scheme.

Members of workplace personal pension schemes are not generally able to choose which firm provides their pension scheme, and many do not make a personal decision about the investment fund(s) where pension contributions are placed. In 2015, the Office of Fair Trading (OFT) found that the market for workplace pensions suffered from a lack of competition on charges and quality, due to demand-side weaknesses and charging complexity.

[26] TPR: Guidance on triggering events for Master Trusts (Nov. 2018) Code of Practice 15(authorisation and supervision of Master Trusts), para 384
[27] FCA: Thematic Reviews/tr20-1- The effectiveness of Independent Governance

To enhance comparison of pension products and drive value for money on behalf of members, the Department for Work and Pensions (DWP), and the Pensions Regulator required pension schemes to set up and maintain independent governance committees (IGCs). IGC 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 interest of members. They undertake the value for money assessment of the scheme.

The role of IGCs in the assessment of value for money delivered by 'relevant schemes' takes into consideration matters mentioned in Box 1 below. Box 1 provides factors that the UK Pensions Regulator require pension schemes to consider when assessing the extent to which charges and transaction costs would affect good value in relation to member benefits.

A 'relevant scheme' for this purpose is a personal pension scheme or a stakeholder scheme into which the employer pays contributions in respect of at least two employees and where the contributions have been deducted from the employee's pay (known as a 'direct payment arrangement').

To enable IGCs to satisfy this duty:

- providers of workplace personal pension schemes or stakeholder pension schemes are obliged to take reasonable steps to provide them (or any governance advisory arrangement) with all information reasonably requested by them to carry out their role[28],
- and all firms authorised by the Financial Conduct Authority(FCA) (including scheme providers and asset managers) are placed under a duty not to unreasonably withhold from the IGC information that would enable the IGC to carry out a comprehensive assessment of value for money. Moreover, they must use best endeavours to obtain, and provide the IGC with information on the costs incurred because of managing and investing scheme assets, including transaction costs. They should also provide information on other costs and charges to enable the IGC to assess value for money[29]

Since 3 January 2018, the FCA requires asset managers to disclose information about transaction costs and other administration charges to IGCs of relevant schemes.[30]

If the IGC's assessment raises concerns as to value for money, they must raise this with the scheme provider and escalate the matter as appropriate (including to the FCA or by making

28 FCA: Handbook (COBS)-19.5.7(2)
29 FCA: Handbook (COBS)-19.5.8G(3)
30 For further information see FCA: Policy Statement - PS17/20 - Transaction Cost Disclosure in Workplace Pensions (Sep. 2017) FCA Handbook – Pension Schemes (Disclosure of transaction costs and administration charges) Instrument 2017

the issue public) if the provider does not, in the IGC's opinion, address their concern satisfactorily.[31]

Like the duty placed on the chair of the trustees, the chair of the IGC must set out in the scheme's annual report (among other things):

- the IGC's opinion on the value for money delivered by the scheme
- any concerns raised by the IGC and the response received to those concerns

A firm (which operates a relevant scheme in which there are at least two relevant policyholders) must take reasonable steps to ensure that the IGC has sufficient collective expertise and experience to be able to make judgements on the value for money of relevant schemes and must recruit independent IGC members through an open and transparent recruitment process.

A firm must appoint members to the IGC so that:

a) the IGC consists of at least five members, including an independent Chair and a majority of independent members;
b) IGC members are bound by appropriate contracts which reflect the terms of reference and terms to secure the independence of independent members;
c) independent IGC members who are individuals are appointed for fixed terms of no longer than five years, with a cumulative maximum duration of ten years;
d) individuals acting as the representative of an independent corporate member are appointed to the IGC for a maximum duration of ten years;
e) independent IGC members who are individuals, including those representing independent corporate members, are not eligible for reappointment to the IGC until five years have elapsed, after having served on the firm's IGC for the maximum duration of ten years;
f) appointments to the IGC are managed to maintain continuity in terms of expertise and experience of the IGC.

Some of South Africa's commercial umbrella funds do have a form of IGCs in their governance structure. Some call them 'joint forums', some 'management committees', and others 'advisory bodies'. They are not recognised in legislation and their functions includes, to assist the

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umbrella fund with updates to member data, ensure that contributions are paid over to the fund, process death benefits with the fund, provide updates to members on the fund and recommend amendments to benefit structures.

These 'quasi boards' can be formalised and standardised in South Africa and be given an

Box 1: How the UK assesses value for money:

'Value for money' (VFM) assessments in terms of an assessment proposed in the UK look at:

a) What the scheme provides for members and at what cost (Are the benefits provided by the fund suitable for, relevant to and valued by members? Have the fund's services to members performed effectively over the past year and do you believe they will continue to perform effectively?),

b) Evaluating the scope and quality against the costs:

(i) whether the scope and quality of each service provides good value for the relevant costs and charges incurred by members and

(ii) 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.

Cost comparison may require a benchmark, e.g. Government Employees Pension Fund or any non-profit fund.

c) Scope and quality of scheme services to members:

i) scope and quality against the costs, whether the scope and quality of each service provides good value for the relevant costs and charges incurred by members and

ii) 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.

d) Taking action to address poor value. The assessment should be applicable to all retirement funds:

i. Decisions to change the scheme or elements within it rest with the employer but it remains trustees' responsibility to address poor value as far as trustees are able. It is important that trustees can work effectively with employers in this regard.

ii. Depending on the issue, there are various ways you can improve value for members. For example, it might be appropriate to remove unused services, re-tender for services, simplify or standardise particular services, obtain a scale-related discount (e.g., to reflect an increase in the scheme's size), membership or assets, reduce a particular charge, or challenge the relevant service provider directly.

iii. In some circumstances, it might be sensible to work with the employer to close the scheme to new members or to close the scheme altogether and transfer members and their pots to a different scheme.

added responsibility of establishing value for money for members. The reason for this consideration is the difficulty of employer and employee nomination and election to the trustee board of a commercial umbrella fund. Typically boards of trustees have a limited board size and the range of employee sizes per employer in commercial umbrella funds can be anything from 50 to 250 000. The challenge this poses is which employees and employers get represented on the board and how would such representatives be nominated and or elected to the board of a commercial umbrella fund. Furthermore, if the umbrella fund had a national spread, there may be additional costs incurred on member/employer board members. The formalisation of IGCs could save costs for umbrella funds that ought to benefit fund members and they should have the following functions in addition to those delegated by the commercial umbrella fund board of trustees:

- Conduct ongoing value for money of the umbrella fund as shall be prescribed; ‘Value for money’ measurement criteria and tools should be established and a conduct standard be 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 them and then close.
- Assist the umbrella fund with updates/information to member data, ensure that contributions are paid over to the fund, process death benefits with the fund, provide updates to members on fund and recommend amendments to benefit structures.

Policy options for SA

As determined in the 2013 Charges paper, National Treasury 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. However, the effectiveness of the current commercial umbrella fund model appears to be compromised by barriers discussed earlier. This, therefore, requires government to come up with policy options that could strengthen the governance of umbrella funds to ensure that member interests are upheld, employers are made active purchasers of retirement funds, and that the degree of competition in the market is increased.

Principles of good governance

The FSCA is already in the process of including measures to improve the governance of funds exempted from compliance with section 7A(1) of the PFA. This follows an announcement by the FSCA to make compliance with applicable principles and practices described in the Report on Corporate Governance for South Africa 2016 (King IV) compulsory for funds subject to regulation and supervision in terms of the PFA.

It has also issued Guidance Notice 4 of 2018 in which it has advised members of the public of the conditions to which it is likely to exempt umbrella funds, retirement annuity funds, beneficiary funds, preservation funds and unclaimed benefit funds from the obligation to give their members the right to elect at least 50% of the members of the boards of those funds. Those conditions include the following:

- That, unless the rules of the fund provide for indirect elections of board members by means of the election by members of at least 50% of the members of local area committees, which committees may then elect the members of regional committees, which may then elect members of the board, at least 50% of the members of the board must be 'independent' as contemplated in the Guidance Notice;
- The quorum for meetings of a fund's board must be no fewer than four board members, which must include independent trustees, and no decision will be valid unless supported by at least 50% of those board members present at the meeting, of which at least half must be independent board members; and
- The board must 'adopt a stakeholder-inclusive approach that balances the needs, interests and expectations of material stakeholders in the best interests of the fund over time, which must be combined with a timeous, regular and relevant communication strategy for the fund and its members'.

In addition to the above-mentioned measures that the FSCA is seeking to introduce, the following:

- Board members including independent ones, should not belong to more than three (3) boards in any year, including membership to company boards so that they are not spread too thinly;
- Independent board members should not be contracted as consultants/service providers to the same fund of which they are trustees.

Structural solutions

Given that retirement savings provision is at the discretion of the employers, they can equally use their discretion whether to use retirement savings provision through occupational funds or commercial umbrella funds. Umbrella funds are marketed to companies, and it is up to employers to evaluate the services and products offered by umbrella funds and communicate that decision to fund members. There is some evidence that larger funds might be more efficient than smaller ones, but the efficiency and economies of scale must be transferred to members. A relatively smaller number of retirement funds will also enable more efficient and effective supervision by the FSCA. For these reasons National Treasury supports an auction system, akin to the Chilean one (see Box 2), and must be conducted under the auspices of the FSCA to enable stand-alone funds to select and appoint default 'consolidation' or auto-enrolment funds when they need it.

The Chilean auction process seems to have been effective in reducing fees levied by Chilean providers. Providers are required to bid for the right to enrol new members of the mandatory DC system who remain captive for two years. Bids cover administration costs and internal investment costs and must be lower than the minimum fee currently available in the market.

Also subject to a bid process should be the provision of services to an umbrella fund. This means it should be prohibited for any commercial umbrella fund rule making the use of a sponsor's service providers compulsory. Therefore, there should be an open tender system put in place for any service, that would include the sponsor as a tenderer in service provision.

Box 2: Use of Auction Mechanisms in the Chilean Pension System

The 'auction' concept is used within other pension systems to allocate members to funds and /or to help direct member choice. For example, within the Chilean pension system, individuals joining the mandatory, individual account pension system who do not wish to actively select a pension provider are allocated to the default pension fund ('AFP'). The default provider is chosen every 2 years based on an auction process by which the existing AFPs bid based on the fees which they will charge. For the payout phase, whereby at retirement individuals must select between an annuity or a programmed withdrawal benefit, a central quotation system, known as SCOMP, has been created through which individuals enter their details and receive quotes from the different product providers on a standardized basis.

Auction mechanism could potentially form part of a revised South African system. For example:

- a central auction mechanism (via a dedicated portal) could be set up for trustees of small funds which do not meet value for money or other criteria to continue in operation can request bids from exiting funds to take over their scheme (alternatively an administrator or the regular could take on this task);
- only schemes meeting certain (strict) hurdle requirements would be allowed to bid for these closing funds - possible on a 'blind' but certainly on a standardized basis to allow for comparison;
- criteria for awarding the winning bid could also be set by the regulator;
- alternatively, the regulator could establish a regular auction (with set criteria) between umbrella funds bidding to become the default 'consolidation' fund for a set period;
- an auction system could also potentially be used to be the default provider under any auto-enrolment system.

Further, it is proposed that the independent governance committees (i.e., advisory committees or management committees in the SA context) be formalised and they should have minimum standardised functions in addition to those delegated by the commercial umbrella fund board of trustees:

- Conduct ongoing value for money of the umbrella fund as shall be prescribed;
- Assist the umbrella fund with updates to member data, ensure that contributions are paid over to the fund, process death benefits with the fund, provide updates to members on fund and recommend amendments to benefit structures.

The transfer of funds based on value for money calculations should be at low cost and no prohibitions to transfer funds will be permitted.

Given the big size of umbrella funds in terms of fund membership, the FSCA should supervise all types umbrella funds more closely and regularly.

Greater transparency to influence the level of costs and charges

The level of fee disclosure to members in stand-alone retirement funds and umbrella funds is low, and in smaller or less-well-run funds, charges may be high. Yet members are automatically enrolled into these funds as a condition of employment. However, increased disclosure is unlikely to be sufficient on its own to achieve lower costs.

Making costs and charges more transparent has been a key objective of policy in most jurisdictions, including South Africa. For example, cost transparency in the Netherlands has led to greater cost awareness among fund boards, resulting in better outcomes for members. Measures to address the issue of transparency were introduced through a series of legal and voluntary requirements.

To strengthen competitive pressure and improve transparency of charges and costs, National Treasury is considering a disclosure-based initiative that would require funds to provide information on their cost structures. There is evidence that introducing measures to improve transparency about costs could improve comparison among products and improve outcomes.

i. Other policy considerations to promote transparency and comparability it is recommended that template rules for umbrella retirement funds in each category (bargaining council, sectoral determination, commercial, other sectoral, employer group and the like) be written in plain language, published by the FSCA and required to be adopted by each umbrella fund on a 'comply or explain' basis by means of an on-line application mechanism in which fund specific details are entered into the template rules on-line.
ii. No 'lock-in' provisions should be allowed in the rules or agreements with providers
iii. If providers of products and services have to compete for the business of providing such products and services to funds granted exemption in terms of section 7B(1)(b) on an 'arm's length' basis rather than being able to rely on their 'captured clients' to buy them, this should improve the funds' prospects for providing 'fit for purpose' and 'value for money' benefits for their members and beneficiaries.
iv. The rules of the fund do not include any provisions which constitute an impediment to the termination of the appointment of the sponsor or a party related to it as a provider of services to the fund or the termination of any agreement between it and the fund in terms of which products and/or services to the fund;
v. The rules should be capable of being amended without the consent of the sponsor unless the amendment is likely to have the effect of exposing the sponsor to financial risk or burden that would not be imposed on another entity of a similar nature if it was to replace it as sponsor on the effective date of the amendment;
vi. More detailed reporting and disclosure standards applicable to retirement funds in various categories could be useful in promoting transparency, accountability, and comparability.

Conclusion

Multi-employer funds can offer cost advantages, allowing small employers to achieve economies of scale that they would not otherwise enjoy in a small occupational fund. However, there are several potential disadvantages with umbrella funds, for example, barriers to entry, opaque costs and charges, and other governance challenges.

Umbrella funds have the potential to strengthen competition through the ability of employers to move between umbrella funds in a low-cost way. Through a combination of different measures to address weak market mechanisms in commercial umbrella funds, it is recommended that umbrella funds should be subject to specific governance provisions. Standardised provision of information on charges is also proposed to enable comparison between funds and to promote effective competition in the case of umbrella funds.

Views are requested on these proposals, stating advantages and disadvantages thereof, practicality, potential effectiveness on member outcomes, and cost-effectiveness, including an assessment of the UK’s Master Trust scheme, a view on which elements would suit South Africa’s umbrella fund structure.