

What is an umbrella fund?

Simply put, an umbrella fund is either a pension or provident fund, which multiple and unrelated employers may join (as opposed to a single fund established only for one employer, i.e. a standalone fund). On this basis, the participants in an umbrella fund will benefit from economies of scale and risk pooling, which potentially translates to significant reductions in overall costs.

Many umbrella funds are sponsored by and have the financial backing of a large, reputable financial institution.

What is the purpose of this document?

- ⌚ To detail some of the issues a Board of Trustees/employer should consider when deciding to convert a standalone fund to an umbrella fund
- ⌚ To provide a basic comparison between standalone funds versus umbrella funds
- ⌚ To highlight the potential cost savings of an umbrella fund
- ⌚ To outline the process involved in transferring from a standalone fund to an umbrella fund

Some industry background

The most recent information from Government upon the likely shape of the future industry was contained in the 2010 Budget Review:

“The basic social security arrangement could be a common, pooled fund to which all employed persons contribute. However, allowing accredited private funds to operate alongside a statutory default arrangement would grant workers access to affordable and secure savings arrangements, while allowing existing provident and pension funds time to adapt to more stringent minimum standards. Accreditation of private funds would cover standards of proper governance, benefit protection and cost efficiency, allowing better-run, more efficient retirement funds to continue to operate.”

This implies only the better run and more efficient retirement funds will be permitted to operate into the future.

It is becoming increasingly clear that most standalone funds and even smaller umbrella funds have no future in the proposed structure. Certain accredited funds may however be allowed to “opt out” of the national arrangement. As the conditions are still unclear at this stage it is difficult to predict minimum requirements that would be set for opting out. There is however a high probability that large umbrella funds, which are managed with integrity, transparency and high service levels at a fee that offers good value for money, would qualify to opt out.

We believe that the Sanlam Umbrella Fund will satisfy the opt-out requirements of any future dispensation. This has been our vision over the past 3 years since Government first announced the National Social Security System proposals.



Key issues to consider before moving to an umbrella fund

TIME	
Standalone retirement fund	Umbrella retirement fund
<ul style="list-style-type: none">○ Intensive management time required with onerous duties for trustees and Principal Officer.	<ul style="list-style-type: none">○ Management time significantly reduced, allowing management time to focus on core business.

LIABILITY	
Standalone retirement fund	Umbrella retirement fund
<ul style="list-style-type: none">○ The company-appointed trustees have fiduciary responsibilities and duties.○ Each trustee can incur liability and damage claims in personal capacity.	<ul style="list-style-type: none">○ Employers must comply with certain duties but will incur no liability relating to the management of the fund.○ Joint Forum members do not have fiduciary duties – but are accountable to their membership.

FLEXIBILITY	
Standalone retirement fund	Umbrella retirement fund
<ul style="list-style-type: none">○ Total flexibility of benefit structure (subject to cost constraints).○ Investment strategy designed by the company-appointed trustees (subject to minimums imposed by some asset managers and portfolios).○ The fund carries the employer's (company's) own branding.	<ul style="list-style-type: none">○ Top umbrella funds can accommodate almost all benefit structures. (Less flexible umbrella funds will limit flexibility to keep costs down).○ Investment strategy designed by employer/Joint Forum (limited by the menu of portfolios offered by the fund).○ The umbrella fund carries the Sponsor's branding.

COSTS	
Standalone retirement fund	Umbrella retirement fund
<ul style="list-style-type: none">○ Generally has higher costs than umbrella funds.	<ul style="list-style-type: none">○ Costs are on average 20% to 40% lower than standalone funds (as per results of Sanlam Benchmark 2010 survey).



Comparison between standalone funds and umbrella funds

1. Legal structure	
Standalone retirement fund	Umbrella retirement fund
<ul style="list-style-type: none"> Registered with the Registrar of Pension funds. 	<ul style="list-style-type: none"> Registered with the Registrar of Pension funds.
<ul style="list-style-type: none"> One set of Fund Rules registered with the Financial Services Board. 	<ul style="list-style-type: none"> General Rules (applicable to the entire umbrella fund) Special Rules for each participating employer (applicable only to that specific employer) Registered with the Financial Services Board
<ul style="list-style-type: none"> Subject to both the Pension Funds Act and Income Tax Act. 	<ul style="list-style-type: none"> Subject to both the Pension Funds Act and Income Tax Act.
<ul style="list-style-type: none"> The two basic structures are Pension- and Provident funds. 	<ul style="list-style-type: none"> The two basic structures are Pension- and Provident funds.
2. Management of the fund	
Standalone retirement fund	Umbrella retirement fund
<ul style="list-style-type: none"> Managed by a Board of Trustees <ul style="list-style-type: none"> Consisting of company appointed and member elected trustees (typically lay trustees). 	<ul style="list-style-type: none"> Managed by a Board of Trustees <ul style="list-style-type: none"> Consisting of Professional trustees and Principal Officer.
<ul style="list-style-type: none"> Members have the right to elect 50% of the trustees. The employer appoints 50% of the trustees. 	<ul style="list-style-type: none"> Top funds allow the Sponsor to appoint 50% of the trustees and the members to elect the remaining 50% from a list of industry professionals that are independent of the Sponsor. (This is done to help manage potential conflicts of interest between the Sponsor and the Board of Trustees.) In some cases the Sponsor appoints all the trustees (including the one independent trustee required by the Act).
<p>The Board of Trustees governs the fund and has fiduciary responsibilities and duties to:</p> <ul style="list-style-type: none"> Manage the fund in accordance with the applicable legislation. Adhere to the latest PF130 Fund Governance principles. Comply with King III Code. 	<ul style="list-style-type: none"> The trustees of the umbrella fund have the same fiduciary responsibilities and duties as the standalone fund. Members of the Joint Forum are not trustees of the fund and therefore do not have the fiduciary duties and responsibilities that trustees have.
<ul style="list-style-type: none"> In most standalone funds, the trustees are also members of the fund. The trustees are in a position to determine the benefit structure and the service providers. 	<ul style="list-style-type: none"> In top umbrella funds, members of each Joint Forum are also members of the fund. The Joint Forum determines/amends the benefit structure and selects the service providers, including the umbrella fund they belong to.



<ul style="list-style-type: none"> ○ The employees of the employer in their capacity as trustees are required to undergo formal training, are potentially liable in their personal capacities and must meet regularly. 	<ul style="list-style-type: none"> ○ The employees of the employer in their capacity as Joint Forum members do not have to undergo training and are not potentially liable in their personal capacities and are required to attend only one meeting per annum.
<ul style="list-style-type: none"> ○ Member communication: trustees are required to assume responsibility for all member communication. 	<ul style="list-style-type: none"> ○ Member communication is prepared and designed by the umbrella fund. ○ Joint Forum of each employer may be required to assist with the distribution of member communication and with member support initiatives.

3. Benefit structure	
Standalone retirement fund	Umbrella retirement fund
<ul style="list-style-type: none"> ○ The trustees are responsible for designing the fund's benefit structure with a choice of: <ul style="list-style-type: none"> - death, disability and funeral benefits. ○ The trustees are responsible for the appointment of service providers. ○ The trustees have to manage the service providers continuously through service level agreements. 	<ul style="list-style-type: none"> ○ Participating employers can design their own benefit structure within the umbrella fund's parameters, with a choice of: <ul style="list-style-type: none"> - death, disability and funeral benefits. ○ Most umbrella funds offer a large degree of flexibility. ○ The umbrella fund trustees are responsible for the selection and appointment of service providers. ○ Typically the Sponsor's products are on offer. ○ More and more umbrella funds (like the Sanlam Umbrella Fund) are creating open architect environments, where other service providers can be selected. ○ The Joint Forum will manage the service level of the umbrella fund and can review the performance of the fund.

4. Investments	
Standalone retirement fund	Umbrella retirement fund
<ul style="list-style-type: none"> ○ The trustees are responsible for the fund's investment strategy. 	<ul style="list-style-type: none"> ○ The trustees are responsible for the umbrella fund's investment strategy and the menu of investment portfolios of the fund. ○ The Joint Forum is responsible for the selection of the most appropriate default investment plan for its members within the trustee approved strategy (on participating employer level).
<ul style="list-style-type: none"> ○ Trustees may appoint specialist investment consultants to assist with the strategy. 	<ul style="list-style-type: none"> ○ The Joint Forum may require a contracted benefit consultant to assist with the selection of an investment strategy and select the appropriate portfolios.



<ul style="list-style-type: none"> ○ Standalone funds that offer individual investment choice to members will prepare a pre-selected list of portfolios that members can choose from. 	<ul style="list-style-type: none"> ○ The trustees of umbrella funds that offer member choice will also prepare a list of pre-selected portfolios that members can choose from.
<ul style="list-style-type: none"> ○ Most funds that offer investment choice will have a default portfolio. That is the portfolio into which all net contributions will be paid – unless otherwise directed. 	<ul style="list-style-type: none"> ○ Top umbrella funds allow participating employers to choose between more than one default portfolio.

5. Costs	
Standalone retirement fund	Umbrella retirement fund
Fidelity Insurance	
<ul style="list-style-type: none"> ○ Fidelity Insurance must be in place to protect the fund against theft and fraud, and errors and omissions. The fund bears the cost of the insurance. 	<ul style="list-style-type: none"> ○ The umbrella fund must have Fidelity Insurance in place, but economies of scale are achieved because the costs are shared amongst thousands of members.
Financial Statements	
<ul style="list-style-type: none"> ○ Funds are obliged to compile and submit annual financial statements. The fund bears the cost of these statements. 	<ul style="list-style-type: none"> ○ The cost of annual audits and financial statements are shared amongst thousands of members.
Administration costs	
<ul style="list-style-type: none"> ○ Are based on the fund's data, no cross subsidies with other funds. 	<ul style="list-style-type: none"> ○ The cost is based on the umbrella fund's total membership, thus better economies of scale are obtained. ○ Since each pay point generates additional costs, members of smaller employer will pay more. ○ The cost for a 100-member employer in an umbrella fund should be cheaper than a 100-member standalone fund.
<ul style="list-style-type: none"> ○ The costs and fees incurred in running the fund (Financial Services Board levies, insurance, auditors, bankers, Principal Officer and trustee costs) are carried by the members, over and above the administration fee. 	<ul style="list-style-type: none"> ○ The costs and fees i.e. (Financial Services Board levies, insurance, auditors, bankers, Principal Officer and trustee costs) are shared by thousands of members and are included in the administration fee or as a contingency reserve levy (or may also be debited as they arise).
<ul style="list-style-type: none"> ○ Increased costs due to member trustee elections and trustee training. 	<ul style="list-style-type: none"> ○ Professional trustees require significantly less trustee training (if at all). ○ Elections should still be done for member representatives (insignificant costs).
<ul style="list-style-type: none"> ○ Communication is usually an additional cost to fund. 	<ul style="list-style-type: none"> ○ The costs are included in the administration fee (although certain printing cost may be excluded).



Indirect costs	
<ul style="list-style-type: none"> ○ The indirect costs – notably opportunity costs when management time is diverted to fund management issues e.g. attending meetings, undergoing training etc. is carried by the employer. It is difficult to determine the actual cost companies incur but these indirect costs should not be underestimated. 	<ul style="list-style-type: none"> ○ The Joint Forum has much less responsibility and fewer meetings resulting in much lower indirect costs.

🔍 In summary

Once these issues have been considered, a move to an umbrella fund is very compelling. The following issues are of particular importance:

- 🔍 The onerous responsibilities and potential liability associated with being a trustee
- 🔍 The dynamic nature of the retirement fund industry and legislation governing retirement funds and the need for ongoing monitoring and change
- 🔍 The increasing need for, and costs of, member communication and education within the retirement fund industry
- 🔍 The economies of scale achieved by adopting the umbrella fund approach that allows a greater allocation of net contributions towards members' retirement savings

The process to follow

🔍 Phase 1

Once a client has decided to move their existing standalone fund to an umbrella fund, there is a process that needs to be followed and completed.

Checklist phase 1: Transfer to the Sanlam Umbrella Fund			
1	The decision to join an umbrella fund	The trustees of the existing standalone fund need to minute their decision (following the agreement with the employer) and agree on the effective date of transfer to the umbrella fund.	
2	Prepare communication to members of existing fund	The trustees should prepare a communication to members outlining their decision and allow 60 days for any objections. If an objection is received, the trustees will be required to respond in writing addressing any issues that may arise. See also point 6 below.	
3	Sign acceptance to join the umbrella fund	It is important to note that the contract will be between the employer and the umbrella fund. On joining the Sanlam Umbrella Fund, an installation guide will be issued that outlines all the processes and timelines that will be followed.	



4	Issue letter of termination to existing service providers	<p>The trustees should issue a letter of termination to the existing service providers of the standalone fund (preferably once all members have been consulted on the transfer). It is critical that the termination date coincides with the inception date of the umbrella fund. This applies in particular to the risk provider/s.</p> <p>Although the trustees may terminate supplier agreements on a specific date, the standalone fund may continue to exist past this date as the Section 14 application may still need to be approved. Only once this is approved will the administrator be able to finalize the termination of the standalone fund.</p> <p>In some cases there might be members that remain in the standalone fund (e.g. pensioners) and the standalone fund might continue to operate for these members.</p>	
5	Request a fund termination quotation from existing administrator	<p>It is useful for the trustees to request a quotation from the administrator detailing the costs associated to closing the fund, so that an appropriate budget can be set.</p>	
6	Formalise investment strategy	<p>The trustees need to formalise their investment strategy whilst the Section 14 is in progress in respect of the transferring members.</p> <p>This strategy must be communicated to members as part of the transfer communication exercise (point 2 above).</p>	
7	Active members transfer to umbrella fund	<p>The existing standalone fund members will transfer to the umbrella fund via a Section 14 process. (The Financial Services Board's approval is not required if both funds are valuation exempt. Other terms and conditions apply).</p>	
8	Calculate individual members' share of fund (Equitable Share)	<p>The existing fund must calculate each member's value in the fund and the total of all these values will be reflected as the total members' transfer value on the Section 14 application.</p>	
9	Submit final Section 14 application to the Financial Services Board	<p>Using the values detailed under item 8 above, prepare the required Section 14 application and submit to the Sanlam Umbrella Fund to finalise their part of the application. The Sanlam Umbrella Fund will then submit the completed and signed application to the Financial Services Board for their approval.</p> <p>Note that the Financial Services Board also has certain regulated fees which they charge to process such an application. In the case of the Sanlam Umbrella Fund the fees are paid from the contingency reserve account and are thus not charged to transferring members.</p>	

➤ Phase 2

Once the active members have been transferred to the umbrella fund, the existing standalone fund must still be closed (assuming no members remain, such as pensioners). To close and de-register a fund, there are a number of administration functions that need to be completed.

The closure of a fund can take place on one of two bases:

1. Via a Section 28 Liquidation (which we do not recommend since this is very costly).



In this case a liquidator is appointed and is required to follow the legislated procedure in this regard.

2. In terms of Section 27 of the PFA, application to the Financial Services Board to deregister the fund after completion of the Section 14 process.

This is the one most commonly used and the most cost effective method. The checklist that follows outlines the procedure to follow in this case.

Checklist phase 2: Closure and deregistration of the standalone fund			
1	Handling any queries	Queries might arise from the Financial Services Board, members, the employer or any related parties.	
2	Follow-up on Section 14 (if applicable)	Ongoing pursuit and follow up of the approval of the Section 14 application whilst it is with Financial Services Board	
3	Continuation of legislative requirements	Completion and submission of the required tax reconciliations to SARS on a monthly basis.	
4	Continuation of administration functions	Ongoing claim payments in respect of any exits from the fund during the Section 14 application process. All administration tasks including issuing of tax certificates, calculation of benefits etc. whilst the Section 14 is in progress.	
5	Transfer of assets once Section 14 is approved	On Section 14 approval the assets are to be transferred to the Sanlam Umbrella Fund. The only assets remaining should be to cover the expenses and costs of closing the fund.	
6	Ongoing cash flow and accounting function	The auditors need to provide a final set of accounts showing that the fund has no assets and no liabilities. All membership payments need to be finalised, all claims of debtors and creditors must be settled.	
7	Finally closure of the standalone fund.		

🔍 Further notes

- 🔍 The usual practice is for administrators to charge a termination fee related to the actual cost of performing all the required functions to terminate the standalone fund.
- 🔍 It is important to note that the fees only relate to those ordinarily charged by an administrator, whose function it is to oversee the entire termination process on behalf of the fund. In some cases there could be additional costs incurred related to services provided by other parties e.g. actuarial calculations for defined benefit funds, external auditing services, liquidator costs etc.
- 🔍 Until the fund has been officially de-registered or liquidated, whereby the Financial Services Board has issued the appropriate documentation in this regard, the trustees of the standalone fund remain responsible for all matters pertaining to that fund. It is therefore important that they remain involved as far as possible and up to date on the progress of the termination.

Please note that this document aims to provide information as a reference guide and does not claim to cover every situation and does not substitute for professional expert advice.