

The Critical Role of an Excellent Consultant when Considering Umbrella Funds

By Viresh Maharaj

Sanlam Employee Benefits

The commercial umbrella fund market has played a highly disruptive role in the South African retirement funding landscape resulting in a more dramatic shift in the landscape than the DB to DC transformation. This is largely due to the rapid transition of smaller and medium sized standalone funds into such structures as well as the convenience and affordability of the umbrella option amongst SMME's across the country.

This market creates a challenging dynamic due to the lack of pricing standards, transparent pricing and variations in disclosure amongst providers. The 2016 Sanlam Benchmark survey that indicated that 57% of participating employers polled found it difficult to factually and objectively compare costs between providers and another 19% said that it was very difficult to do so.

As such, we can infer that high quality guidance is required to enable employers and funds considering the umbrella route to understand the material qualitative differences between the available commercial umbrella funds and to then be able to quantify and compare the actual charges being levied. This is the domain of the excellent consultant.

In our view, an excellent consultant displays a combination of the following characteristics, which I've briefly described below:

- They are passionate about moving more members towards better outcomes

An excellent consultant is able to evaluate the current retirement funding position of members, apply a target and implement the necessary corrective measures at fund level to move more members towards such a target. This necessitates being knowledgeable about the various products available so as to make qualified judgement calls on how to best achieve one's targeted goals. Unfortunately, we have engaged many intermediaries who are comfortable with understanding a very limited range of providers' products and are not willing to explore credible alternatives. This is often to the detriment of their clients and, increasingly, they are being replaced by excellent consultants.

- They are able to understand, unpack and compare all costs

As discussed, umbrella fund charges are not transparent across the industry and an excellent consultant needs to apply professional analytical ability to trawl through the fine print to translate the layers of fees into a measure that can be compared across providers. The incoming Effective Annual Charging standard will greatly assist once it is active later in the year but employers are currently entirely reliant on the consultants' ability to apply their expertise to assist them. Canny providers have sought to arbitrage this situation and have often succeeded where consultants have not unpacked hidden layers of net prices asset based fees, expensive guarantee fees on default portfolios as well as a host of other practices. An excellent consultant will do so in order to enable high quality decision making.

- They are able to communicate qualitative differences in value provided

Warren Buffett once said, “Price is what you pay, value is what you get”. The umbrella fund choice is not an exercise to determine the cheapest provider but, once again, we have experienced intermediaries who are willing to risk their reputations by recommending a particular fund simply because it is the cheapest with no regard for the host of qualitative differences between funds. Such practices may have hugely detrimental effects on employees’ abilities to create long term wealth as while fees are important, they are but one component of an ecosystem of other components that collectively move members towards better outcomes. An excellent consultant is able to compare value and discuss the dynamic between the cost and value of different providers by evaluating the ecosystem rather than just a single component. Post the introduction of the Effective Annual Charging standard, consultants that merely compare costs will be redundant.

- They provide independent advice

Consultants who are inextricably linked to a particular umbrella fund may have an inherent conflict of interest as they effectively act as tied agents of the relevant sponsor. Such consultants typically have very limited insight into competitor products and would therefore not be in a position to recommend alternatives to their native solution even if such alternatives were a better fit to the clients’ interests. There is an inherent conflict of interest when the consulting firm is also the umbrella sponsor as employers face the risk of receiving advice that is driven by business interests rather than by the financial needs of their employees. It is perhaps worthwhile to ask one’s consultant whether they have ever considered alternative providers for your own fund as well, whether they have ever conducted a market test for your fund and whether they have funds at other providers to get a sense of their degree of independence. Employers and funds that currently utilize such consultants have increasingly contracted independent consultants to conduct objective reviews of their retirement funding structures with a view to understanding the alternatives available.

- They apply influence

Independence allows a consultant to objectively compare alternatives but this alone may not result in the best deal for the client. An excellent consultant is able to apply influence to providers to enhance the value proposition to clients in order to improve the deal being offered. Thus, an excellent consultant moves beyond the role of a quantitative and qualitative aggregator and is able to differentiate themselves by enhancing the value delivered to members by negotiating rates, structures and conditions with providers for their clients.

Given the rapid growth in this market, excellent consultants are required for funds and employers considering the switch to umbrellas as well as for existing participating employers within umbrella funds. Employing excellent consultants can materially improve outcomes for members and should be considered as a priority action. As an employer or trustee, one must evaluate whether the consultant attached to your retirement arrangements fulfils the criteria of excellence and then act accordingly.