



Due Diligence of Umbrella Funds

A sketch

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Setting the Scene

Fagmeedah Petersen-Cook is an independent Director of a listed company that is considering moving to an umbrella fund. The HR Committee of the Board, which she chairs, has been asked to oversee the selection process

Carlyle Field is a partner at a law firm, and an employee benefits specialist

Sometime in the near future



Slide Title

Topic: What legal risks should be included when doing a due diligence on an umbrella fund?

What is the legal obligation of the employer when ceasing participation in one fund and commencing participation in an umbrella fund? What are the key aspects to look at when doing a due diligence? Should the employer obtain advice from different experts? How often should the employer do this exercise and is a review different from the due diligence of a new fund?

Why is the employer terminating his stand-alone occupational fund?

Drivers of the adoption of an umbrella fund from the employer

- Employer's Fiduciary duty
- Employer's Governance budget
- Level of involvement / executive management time

Influence type of Umbrella Fund considered

- Best of Breed
- One-stop shop
- It is important to select an umbrella fund that meets the needs of our employees and our HR staff
- Who can help the employer in this process? Independent industry specialist

Objectives for using an umbrella Fund

What is the sponsor?

- pensions administration specialist
- Large insurer with multiple businesses, including insurance, asset management, brokerage, etc

Implications for choice of service providers for insurance, asset management, asset consultant

Implications for Relationship between sponsor and service providers

S13B5a of the act prescribes that administrators must

“...avoid conflict between the interests of the administrator and the duties owed to the Fund...”

The Sponsor

Governance issues to be reviewed

What are the risks to the construct of Umbrella Fund Governance relative to the sponsor?

Fundamental issue is the independence of the Trustees and the Principal Officer – will the Board challenge the sponsor on fees and performance?

Employer's duties towards employees requires initial due diligence of proposed provider.
Preferably by an independent third party.

Not a set legal requirement but advisable to review every 3 years.

Governance issues to be reviewed

- Assessment of Board composition, in particular to establish degree of independence from sponsor;
- Appointment/removal/remuneration of independent Trustees and Principal Officer (Directive 8);
- Assessment of regulatory compliance with items such as AFS, valuations, rule amendments etc;
- Track-record (PFA complaints/FSCA enforcement orders etc);
- Review of termination issues, in particular section 14 implementation (timing) when leaving for another fund;
- Assessment of participant committee structure – what support is provided by the Fund? Is a consultant made available to support the committee wrt to issues such as admin, claims and investing reporting?

Who are the typical service providers to an umbrella fund?

Who appoints them?

What are the typical fee structures?

How do we as clients ensure that we are paying competitive fees and obtaining value for money?

Costs/Service Providers

Cost/Service Provider issues to be reviewed

- Identification of various service providers appointed by the Board – including where various service providers are available to the Management Committee versus where Fund is obliged in terms of its rule to utilise a certain service provider (e.g. sponsor for administration)
- General comparison of total administration fee to other umbrella funds (as well as existing stand-alone fund if applicable for completeness);
- More so, a review of specific costs (eg. administration) benchmarked to independent service providers (again as well as in comparison to existing stand-alone fund).

Cost/Service Provider issues to be reviewed

Fee Type	Levy basis
Administration fee	Rand per member per month
Asset-based administration fee	Total assets
Risk-benefit administration fee	Rand per member per month or payroll
Commission on Risk Benefits	Levied on payroll
Participant administration fee	Single amount dispersed across payroll
Investment Switching fees	Rand per transaction, deducted from member record
Governance or Scheme levy	Rand per member per month
Investment platform fees (to accommodate external managers)	% of assets
Broker Commission or Advice fee	Levied on payroll

Costs/Service Providers

Cost/Service Provider issues to be reviewed (continued)

- Important to review costs according to the same scale eg. not salary based versus asset based;
- To what degree is there a cross-subsidisation of costs attributable to one service provider (or sponsor) – eg. are lower/nil admin costs really just factored into risk benefit costs and/or investment fees?
- Disclosure and transparency of costs to members and employers;
- Remember to factor in the invoiced professional fees for standalone funds (Auditor, Valuator) over and above investment management fees, risk premiums, etc if not included in total expense fee – key issue is to identify all costs incurred by members whether directly or indirectly.

Administrator/Systems

The sponsor typically administers the Fund

Does the administrator have a S13B license? When was it last renewed? Are there any restrictions or conditions attached to the renewal? Did the licensing audit have any findings?

Performance track record of sponsor as administrator and potentially insurer?

Administrator/Systems

Administrator/Systems issues to be reviewed

- Section 13B license;
- SLA's: most notably any SLA's with the sponsor (as administrator, asset manager or any other type of service provider);
- Review ability of the Fund to contract with third parties (outside of the sponsor) for the provision of services/benefits;
- Key issue is extent of indemnification provided for losses caused;
- This is also where other key legal issues like POPIA should be addressed.
- Track-record (PFA complaints/FSCA enforcement orders etc) in respect of administrator;

As a potential client, I want to have a good understanding of the user experience for both the employer and our employees who will become the members of the Fund

What is the digital enablement for submission of monthly data and claims processing?

Will the monthly administration process of updating of contributions be relatively easy? We have 40 paypoints across the country, and we use SAP for our payroll. Ideally, we want integration of the administrator's front end with our payroll system, to avoid duplication of effort.

We want to know that our HR resources will have easy access to assistance when queries arise.

Member experience – online platform, accuracy of member information, financial planning tools,

Administrator/Systems

Review of administration platform

- Administration platform;
- Review of member related systems eg. implementation of investment switching;
- Review of employer related systems (contribution payment platforms, allocation of contributions etc);
- These reviews conducted with detailed input from Employer HR Dept.

Administrator/Systems

Ongoing relevance for members

- Online access
- Financial Planning tools
- Projections, consolidation of other retirement pools
- Member communication
- Accuracy of information

Defaults – investment options for lifestaging, preservation, annuitisation

Member interface/Communications

Communication issues to be reviewed

- Review of adequacy of benefit statements, membership booklets and related documents required by law;
- Review of additional communication material provided eg. member bulletins, investment reports;
- Review functionality of online portal for employer as well as any online portals available to members (some funds using apps);
- Assessment of consumer awareness (membership surveys, member presentations and education etc);

Member interface/Communications

Effective spend of Governance budget: participant management committee wants to focus the bulk of its time on investment strategy.

- In-house range of portfolios with a lower fee structure, vs more expensive externally managed portfolios?
- Who is the manager behind the in-house range, and how well are they regarded?
- What does the lifestage model look like?
- Which manager manages the lifestage range?

Are a range of Normal Retirement Ages available for the lifestage model, or is it set up for a particular NRA, regardless of the NRA of a particular participant?

Investments

- Benchmarking of returns within portfolios (track-record) in respect of the in-house range of funds, specifically the default portfolios.
- Assessment of appropriateness of investment strategy for class of employees – a broad spectrum of options for member investment choice is not necessarily beneficial for low-income employees unless appropriately educated or guided;
- Is the lifestage model appropriate for the class of employees having regard to typical length of career?;
- Assessment of how often and by whom the investment strategy is reviewed;



Any Questions?

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