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STANDALONE VS UMBRELLA PENSION FUNDS – WHICH IS BETTER?

CONSIDER THE BENEFITS AND DISADVANTAGES OF EACH

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Currently South African investors are in limbo, waiting for the finalisation and implementation of the National Mandatory Pension Fund (a comprehensive social security and retirement reform). Commentators are unsure whether this will be introduced successfully considering the government's failures with entities such as Eskom and the e-Toll Project.

In South Africa, retirement funds are a crucial component in assisting and preparing employees for retirement. Contributing towards a pension fund whilst working helps employees to save money, ensuring the availability of sufficient funds for their retirement years.

The two types of pension/provident funds available to persons employed within South Africa are standalone or freestanding funds and umbrella funds. A standalone fund serves just one employer, whereas an umbrella fund combines many employers under one legal structure. Both have different qualities and features which might make it challenging for companies to decide on the appropriate fund for their employees' retirement planning requirements. Herewith the benefits and shortcomings of each:

STANDALONE FUNDS are established and maintained by a single employer company or large group structure of companies and are aimed at exclusive benefits for their employees. For employers who lack the size required to extract scale benefits, a standalone fund structure is expensive and possibly more complicated than the standard umbrella fund. Being in a standalone fund could be challenging for small to medium sized businesses, as their management requires a lot of administrative and legal compliance.

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Standalone funds also carry a greater risk of responsibility because the trustees (the employer/group of employees) are entrusted with ensuring that the fund is managed correctly and that the members' interests are safeguarded. These trustees must also adhere to the regulations of the FSCA (Financial Sector Conduct Authority).

Even with these complexities, standalone funds have certain benefits. Since the trustees can customise the fund to meet their own needs and objectives, they have a greater degree of flexibility and control. This enables the company or group of employers to offer specific investment choices and benefits to their employees and, therefore, standalone funds also enable a more individualised approach to retirement planning. Additionally, both funds have the same level of governance, where independent standalone funds (size wise) are deemed less expensive in the long term in comparison to umbrella funds, since they are not subject to the same regulatory obligations – by not having professional trustees (company employees). But with that said, too many cooks do spoil the broth.

Analysis shows that allegedly some trustees share the Dunning-Kruger effect and may suffer from a conflict of interests within these big pension funds. Reason being that nobody questions their intentions and/or competency. This brings to the fore terms and conditions relating to non-related administration costs and inflated fees, as several individuals are involved in these standalone funds and each one's fees for services rendered must be included in the deductions made from member contributions. Not to mention that a certain level of assets under management (AUM) and monthly contributions towards the fund must be attained and maintained for the fund to be cost-effective for both the company and its employees.

UMBRELLA FUNDS: The establishment and management of **umbrella funds,** on the other hand, is the responsibility of a registered fund administrator, such as the likes of insurance companies (also referred to as the sponsor of the umbrella fund, who represents 50% of the board of trustees of such an umbrella fund). Since these registered fund administrators sponsor the administration and management of the fund, umbrella funds typically offer lower fees and are less complicated than standalone funds. In addition, umbrella funds have lower legal risk because the sponsor, together with the board of trustees, ensures that the fund is managed and governed in accordance with legislation, so as to safeguard the members' interests.

Despite these benefits, there are also disadvantages to umbrella funds. Since the sponsor and the board of trustees have to accommodate numerous employers, they tend to offer less freedom, flexibility and control. The board of trustees often offers a standard set of investment options and additional benefits that are the same for all members. Umbrella funds also have a more universal approach to retirement planning, with the majority of umbrella funds offering an investment life stage model as their default investment strategy, with the main objective of reducing investment risk as a member nears retirement. Do keep in mind that if there is a third-party administrator or facilitator connected to your funds to assist with risk rates, then there will be fees binding that relationship to a monetary income for said company.

In conclusion, employers must be cognisant of the advantages and disadvantages of standalone and umbrella funds when selecting a pension/provident fund for their employees. Standalone funds often cost more and require more input, but give flexibility and control to the employers if they are willing to accept that they will be held liable and accountable for their actions and decisions. On the other hand, umbrella funds are less expensive and uncomplicated, but provide less flexibility, and the liability and accountability vests with the sponsor and board of trustees.

Before making any decisions on pension/provident funds, it is crucial to seek guidance from an independent financial advisory firm. The decision between a standalone fund and an umbrella fund must be based upon correct and transparent data and must take into account all relevant information. This will ensure that the employer makes an educated and correct decision when choosing the appropriate fund for their employees.

If you are unsure whether your current fund (standalone or umbrella) is meeting your needs, then it is recommended to have an experienced company perform an audit to give you a clear understanding of the current functioning of your fund and what changes, if any, should be introduced for the benefit of employees.

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