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STATE OF THE PENSION FUND INDUSTRY

RIMCA Monthly Whitepaper

Why Umbrella Funds are Part of the Solution to Our Pension Fund Woes!

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Risk & Investment Management Consulting Actuaries

With one of the world's highest unemployment levels, an ultra-expensive financial services sector, an SMEs-driven economy, very small average fund size, and a significant informal sector, the Zimbabwean pension fund industry is most perfectly placed for a speedy-but-structured transitioning into a robust and dynamic umbrella-fund-dominated sector. All it requires is a genuinely member-centric leadership from the industry key players and the political will from the authorities.

Commonly known as superfunds in Australia, and as umbrella funds by our neighbours down south, this model of managing retirement savings has gained global prominence over the last couple of years. Not surprisingly, Australia is now ranked number three globally in terms of the best countries for pensions and retirement savings management - just behind the pension fund management whizzes of Netherlands and Denmark. At Aus$3 trillion, Australia has bull-dozed its way, over a four-decade period, to a respectable position four in the global ranking of pension fund industries by size of total sector assets. A lot of this can be directly attributed to the emergence of superfunds and all the enabling regulatory changes that has given rise to it and continued to support it over the last four decades. Closer to home here, South Africa remains incomparably way ahead of those in its league on the same measures. That gap is ever increasing too, and so is the gap when comparisons are on the basis of the proportion of pension fund assets to GDP.

An umbrella fund, or a superfund, is a retirement fund in which multiple and unrelated employers may join as opposed to a single fund established for one employer only (i.e. a stand-alone fund). By outsourcing the management of their employees' retirement savings matters to a specialist board of trustees, the immediate and long-lasting benefits for employers are that they can focus a lot more on their core business while experts are left to do all the retirement savings management hard work. The pressure to keep pace with increasingly more-and-more onerous regulatory requirements means that assigning this specialist function to outside experts is the only ideal thing to do.

There are three main types of umbrella funds - public umbrella funds, industry umbrella funds, and commercial umbrella funds. While we have both public and industry umbrella funds, we neither think of them as such, nor have we structured them in the true spirit of umbrella funds. Private sector attempts to create commercial umbrella funds has lacked both political will and resources required, it would appear. All is not lost though, the opportunity is still there for challenger brands to step forward and assume leadership along probably the only path that can take us out of the current pension fund woes we find ourselves in.

Cost Effectiveness

Ultimately, retirement savings management is about nothing else other than ensuring that we put as much of a member's contributions into their "savings pot" as possible. Any leaks out of that pot, or in the conduits that lead to that pot, need to be plugged tightly. The larger a retirement fund is, the higher are the benefits from economies of scale that trickle down to members. Administration fees and asset management fees especially, can a lot more easily be negotiated favourably where trustees wield a lot of bargaining power due to the size of their fund. In fact, not only are trustees able to negotiate for lower fees, they are also able to structure the whole fee arrangement with all the service providers to best meet the fund's interests.

Furthermore, in a market with much fewer, but large funds, trustees will be able to carefully pick and choose the most appropriate and competent skill to work with from all that will be available across many different service providers. Effectively, trustees will be claiming back their true client sovereignty status in a sector where they currently are at the mercy of the service providers.

Service provider fragmentation, lack of specialisation and the so called "one-stop-shop" phenomenon have all left many retirement fund members wondering if these service providers are there to serve them or simply to enrich themselves. It cannot be that where the industry can hardly deliver, in any one given year, a handful of members into a comfortable retirement that the status quo can be allowed to go unchallenged. Of course, the industry is operating in a non-normal environment, but it is also expected to roll its sleeves up and work hard towards creating paths that can at least start to take a meaningful size of our members towards retiring with dignity.

Robust Governance Framework

Whereas standalone corporate funds are usually under the custody of employees of the company appointed as trustees, umbrella funds are managed by professional boards of trustees. These would be financial services professionals with a grounded understanding of how retirement funds work. Umbrella fund board compositions usually include investment experts, pension lawyers, actuaries, chartered accountants and career employee benefit consultants and administrators. This depth and breadth of competence ensures that the boards are intellectually self-reliant and need not be depended on outside advisors who could be driven by nothing else other than an insatiable desire to milk as much profits from the funds as is possible.

Not only are these trustees usually independent to the umbrella fund-sponsoring entity, their interests are made to align with those of the members through performance-driven, member-centric, remuneration structures. A carefully-conceived trustee appointment policy will ensure that there is a cordial, but arms' length, relationship between the trustees and the fund sponsor.

This high degree of governance effectiveness brings about the much required transparency and trustworthiness - both of which are considered currently missing in the sector by its own key beneficiaries.

Where retirement funds are run by industry professionals it makes for easier and more effective engagements with the regulator. When trustees themselves speak, voicing out their concerns as the true legal owners of assets, a more engaging conversation is likely with the regulator than when the trustees speak via third party messengers in the form of service providers whose true loyalty to the mission of the members the regulator can always easily choose to doubt and question.
While on the one end this entails that the funds can more clearly organise themselves and wield enough power to influence government policy, it also means that the regulator can a lot more effectively regulate an industry with now much fewer players.

Fierce competition from a few, but dominant and non-colluding funds, all fighting to remain relevant, will also ensure that members are able to claim back their royalty in the industry.

Positive Economic Impact

Globally, pension funds are playing a very critical role in turning the fortunes of their economies. If there is one country and economy that could hugely benefit from a transformed and dynamic retirement fund industry that would be our dear motherland.

There is no doubt our fiscus cannot afford to fund all the required infrastructural projects. We are lagging several decades behind in terms of our infrastructural stock, and difficult an admission as it could be, there are no signs in sight that things are just about to get any better. Besides, in modern economic dispensation, it is no longer considered the role of the government alone to champion infrastructural developments. Instead, infrastructure has become such a high yielding investment class that investors are now paying particular attention to. It remains though mainly the preserve of large institutional investors with size and capacity on their side to make investing in infrastructure a prudent and noble investment.

Our neighbours down south have just proposed to ramp up pension fund asset allocation to infrastructure to 55%. There could never be a more serious show of commitment and alertness to the critical and strategic dual role that infrastructure plays, both as a return-generating and economic-growth-driving asset class, than this.

Where retirement funds are willing and capable investors in infrastructural projects, the government is relieved of the pressure to finance such projects from the fiscus. This will also help address the long drawn out and contentious issue of prescribed assets regulation.

Our current, fragmented and small-fund-dominated, industry remains a far outcry of the required structure to mobilise and pool together the needed resources for infrastructural projects. Only a consolidated, structured, focused and real-investment-driven industry will be able to provide the all-critical pro-infrastructural development capital required.

In fact, the whole push towards alternatives away from the traditional asset classes is only feasible where a fund can withstand expanded allocations to less liquid assets like private equity and private debt. Together with the bulk of the other alternative assets, allocations to these assets result in funds actively investing directly into the real economy. The potential for triggering GDP growth, employment creation and poverty reduction that this brings about can never be over emphasized.

ESG consciousness and socially responsible investing, policy matters very close to the regulator too, are also only meaningfully plausible for huge investors sitting on very large pools of assets. Not only does a remarkably well-sized pool of assets give an investor bargaining power to influence practices in the investee companies, it also allows it to select and invest in sectors it deems it can have the most social impact. These sectors and opportunities might not be easily accessible to smaller retirement funds.

Diversification is thus much easier to achieve with a well-structured and reasonably-sized umbrella fund. Even the easing of foreign investments being mulled by the Ministry of Finance will only remain a pie in the sky for many funds as they are currently way too small to effectively invest offshore.

Value Add, Flexibility and Member Choice

Contributions towards retirement savings are in principle a form of a delayed salary to an employee. To be fair, considering the compulsory nature of contributing towards retirement fund savings, they should be accompanied by a wide enough range of choices. Members should be granted enough flexibility to be able to allocate and invest their contributions in a similar fashion they would have invested them had they voluntarily decided to set that portion of their salary aside for retirement savings purposes. Umbrella funds are forced to be member-centric in their design due to competition. Those that do not come up with enough flexibility will struggle to grow membership.

Members can also be given the option to choose between a handful of umbrella funds when they join a new employer should they not be happy with the employer's default choice. With technological advancements, this should be quite possible in a cost-effective manner. This would simply follow the same processes payroll/human resources use when employees submit details of their bank of choice. In a market with only a few well-known and properly regulated umbrella funds there will be no need for the employer to carry out any further ongoing due diligence of their own. This is in a similar manner to the way they do with banks unless something obnoxious is brought to public attention.

Each umbrella fund will also provide a variety of choices, over and above its range of default options, for members to select from.

Other than expenses of running the fund, the other significant upfront deduction from members' contributions are risk benefit premiums. The bargaining power of well-sized umbrella funds means they are able to negotiate best risk premiums for their membership. It also means they are able to structure policies where they can participate in mortality or investment profits sharing with the insurer - much to the benefit of the members. They will also be able to design, with the insurers, exotic benefit structures that speak directly to the real and ever changing needs of their members. This will also extend to the post-retirement benefits including the annuities members will access on retirement - currently an area not heavily focused on by funds as they seem to see their role as being only of taking members to the retirement date and leaving them to be on their own once they have cut ties with the employer. Umbrella funds, by design, are member-centric and would ideally prefer to remain being of service to a member long into their retirement lifetime as well.

As they are sponsored with a profit motive, commercial umbrella funds are driven by a fear of being competed out by other funds set up for the same reason. This fear of losing out hugely benefits members. Competition forces funds to be innovative and provide additional benefits that otherwise the traditional not-for-profit sponsors would be under no pressure at all to avail. Some of the latest state-of-the-art member communication technology releases to markets are umbrella funds-spearheaded. Reliance on service providers to drive this alone under the current traditional set up has been such an absolute failure.

One of the key challenges that have continued to baffle both practitioners and regulators alike is the behaviour of members to be generally totally disengaged most of the time, or overly engaged for the most wrong reasons, with respect to their retirement savings matters. Members tend to be engaged only on two occasions in their whole career. When they do, they overly do so. They are either only engaged when changing jobs because they are planning on prematurely "dipping" into their accumulated fund credits, or only when they are about to retire at which point it will be too late should they find out that they are inadequately funded for their life-in-retirement needs.

Umbrella funds in other jurisdictions have been successfully addressing this by engaging with the regulators and making certain provisions of the applicable acts more member-friendly by allowing the addition of benefits that make retirement funds long term investment vehicles with ancillary immediate benefits as well. Home loans, personal loans, health insurance, retirement benefits counselling, robo-advice and loyalty cards are just some of the many auxiliary financial services that umbrella funds have been rolling out to their members after successfully lobbying their regulators to make provisions for such in their laws governing retirement funds.

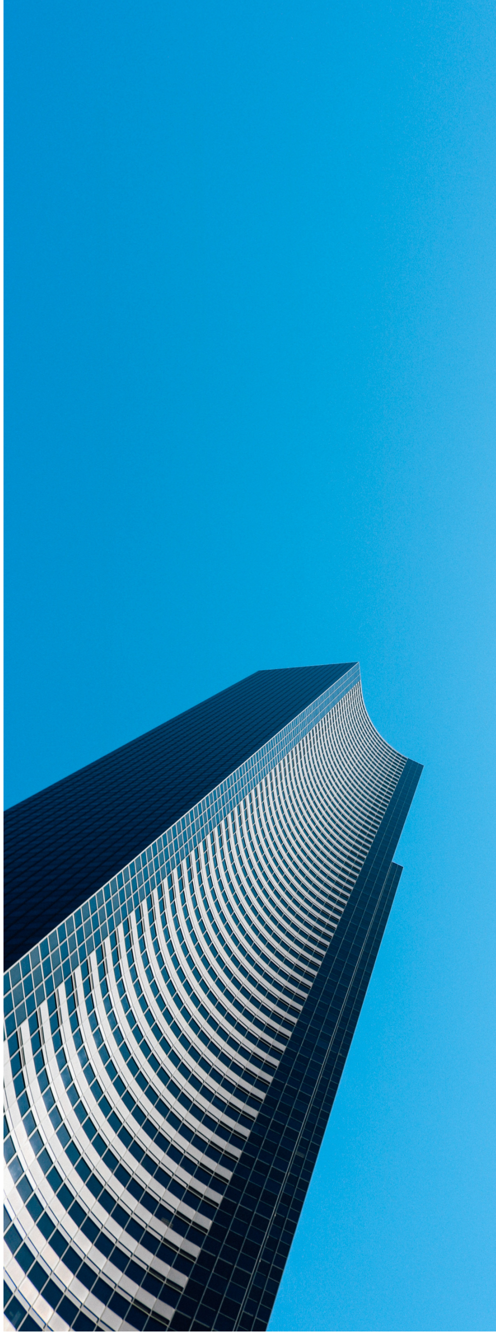
Where these have been successfully rolled out, not only has the level of member engagement increased leading to better retirement planning, it has also resulted in an upsurge in retirement fund membership as members come to see the immediate benefits of contributing to a retirement fund.

There will also be a lot of indirect benefits that will accrue to society at large including an improvement in the national savings rate, reduction in reliance on foreign capital, improved household balance sheet diversification away from just property, and accelerated development of our capital markets.

Furthermore, with more workers retiring financially independent, not only is the burden made lighter for the fiscus with respect to taking care of the elderly, it also means an expanded base from which to tax as more people will be receiving a pension in retirement.

Conclusion

To wrap up, the current state of affairs of the pension fund sector calls for serious engagement between the industry and the regulator with a view to mapping out a new path forward. Doing more of what we have been doing does not appear like the best advised approach to solving the same problem that the same approach has not been able to solve before.



Our monthly publication is aimed at inviting conversations from like-minded individuals with a view to engaging in forward-thinking-led discussions on how we can collectively improve the state of our industry.

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