DELIVERING VALUE: IMPORTANCE OF FEE INTERROGATION WHEN SELECTING A BENEFICIARY FUND PROVIDER

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Beneficiary funds are unique financial instruments that have been established to meet a specific and very important function – the care, benefit and upliftment of minors who would otherwise be left destitute following the loss of a primary breadwinner.

Should a board of trustees determine that a Beneficiary Fund is the best tool to administer the pension fund of the deceased on behalf of beneficiaries and dependants, a key consideration when selecting a provider should be fee structure.

Essentially fulfilling the role of a pension fund for minors, this money needs to be invested with the best interests of the child in mind. The main goal of a Beneficiary Fund should therefore be capital preservation – and costs and fees are the greatest threat to this.

Accordingly, both fund returns and costs should be considered to determine the ultimate value that a beneficiary will derive. Ideally this approach will ensure that Beneficiary Funds will meet the basic needs of beneficiaries, be it the payment of school fees or the purchase of books and clothing, with sufficient funds left over for a lump sum payment when they reach the age of majority.

While there will always be a cost linked to administering any fund in this manner, trustees are tasked with ensuring fee structures, administrative costs and other charges do not erode the value of the fund as this will materially impact the benefit that the beneficiaries receive. Unfortunately this is not an easy task due to the level of complexity inherent in the market. Comparing apples with apples when it comes to costs, fees and charges is virtually impossible as structures differ greatly from one provider to the next.

Some providers charge rand-based fees while others charge based on a percentage of the fund value. There are also those that use a combination of the two. Additional and hidden costs such as audit fees, statutory levies, taxes and multi-manager and asset manager fees also need to be considered.

As an example, provider one may charge an induction fee of 1% excluding VAT, and an annual administration and reporting fee, while provider two may offer the same but with a minimum fee. While this may not seem significant on the surface, it is the smaller funds that get penalised most when minimum values are applied as it eats into more of the capital sum.

And with funds of between R20,000 and R100,000 making up the majority of the market, every rand saved at the inception stage can have a significant impact over time. Additional fee structures, often hidden in the fine print, can also be found in administration costs. Where provider one includes everything in the annual admin fee, provider two may charge an annual admin fee with additional costs like bank fees charged over and above.

Dissolution fees, which can often run as high as 2% of the fund value, are also often charged when a fund is closed, further eroding what is often a recipient's only form of financial support as they start their adult life.

As such, without the ability to easily compare fee structures before placing funds, trustees are tasked with the onerous job of interrogating fund costs and fees before selecting a provider. They therefore need the right tools to enable them to make more informed decisions in this regard.

Trustees need to, first and foremost, understand how a high fee structures can erode the fund value over time by looking at the investment horizon and determining how initial, annual and other administrative fees reduce the impact that compound interest can have on the principle sum. Trustees then need to interrogate the fee structures of the providers they are considering to ensure they understand the cost implications of their choice. They also need to ensure that the charges are fair and commensurate with the level of service offered and the returns that are delivered by the provider.

Industry regulators could greatly improve the ability of trustees to deliberate on fee structures by implementing a standardised industry measure that could help trustees compare costs, fees and charges on a like-for-like basis.

Regulatory changes to cost disclosure requirements would also deliver greater transparency in this regard to further assist in the decision-making process.

Without these tools it becomes extremely difficult for trustees to make the all-important decision of appointing a beneficiary fund provider that will ensure beneficiaries derive the greatest value, which is, ultimately, the purpose of these funds.