PLA QUARTERLY BRIEFING

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John Murphy
Pension Funds Adjudicator

Introduction

1. Good morning and thank you once again for the opportunity to address you. First of all let me apologise for having postponed this workshop. Sometimes my programme gets full and I am compelled to rearrange my commitments. I trust I did not create too much inconvenience.

2. Much of interest has transpired these last six months. Not least because we have reached a significant moment in the expansion and ongoing development in the office, but also because there have been some key decisions from both the ordinary courts and my office.

3. Today, as is my usual practice, I want to talk first about administrative and budgetary matters concerning the office, and then I shall look at some of the decisions.

4. Earlier this year one of our investigators, Lisa Shrosbree, resigned from full time employment. Although she has continued in a part time capacity, this has meant that besides myself there have only been two other investigators writing determinations, namely Sue Myrdal, who until recently was employed on a part time basis, and Naleen Jeram. At the same time we have been able to strengthen Ian McDonald's department, where we now

have two part-timers and one full-time professional clearing complaints by means of negotiation, advice and conciliation.

5. The complaint rate remains constant at about 110 complaints received per month. Although my office manger claims there has been a recent surge to 150. Our overall statistics reveal that we are clearing about half of those on a monthly basis. Consequently, earlier this year I submitted a budget of approximately R5 million in order to ensure an effective level of expansion. This has now been approved and I have gone ahead and made additional appointments. Unfortunately, we cannot expand fully until we acquire more office space. We have secured other premises from 1 September 2001. This regrettably means that we shall cease sharing premises with the Life Assurance Ombudsman.

6. From 1 July 2001 the following full time members of staff will be involved in writing determinations Sue Myrdal, Naleen Jeram, Karin MacKenzie and Cikiswe Nkulu. Sue Myrdal has agreed to come on board full time and shall now act as my deputy. The full time investigators will be assisted by two part time investigators namely, Sheila Pollard and Lisa Shrosbree. There are also two full time junior positions which I propose to fill when we move to our new premises. Ian McDonald shall now be assisted by Jacqui Smith (full-time) and Nuku van Coller (part-time).

7. Once the vacant posts have been filled, I hope we shall be at the staffing levels required for us to meet our mandate. Should any further expansion be required, I would prefer the work to be farmed out on a contract basis to a panel of part-timers constituted for that purpose. At present there are approximately 1500 files on hand requiring investigation. Of these 319 are ready for determination. This means that once all the investigators have been appointed each one shall have a reasonably manageable case load of

approximately 40 files. It should be possible for one investigator to clear 40 files within a 3-4 month period. Once this is done, it should mean that from about December any complaint lodged with the office should be cleared within a 6 month period.

8. As I have mentioned previously, a decision was taken in principle last year for my office to oppose section 30P applications in the High Court in appropriate cases. This has required us to make provision in the budget for legal costs. Obviously we shall be selective and shall only file opposition when the interests of justice so require or where it will be in the public interest to do so.

Decisions of the Ordinary Courts

9. Perhaps the most interesting decision to come from the ordinary courts is that of *Mostert v Old Mutual* . Mostert instituted action against Old Mutual in has capacity as curator of the CAF Pension Fund. His action was for damages in an amount of R48 million for an alleged breach of contract, or alternatively breach of a statutory duty or an ordinary common law delict.

10. The fund had been an exempt fund operating exclusively by means of an insurance policy issued by Old Mutual who also administered the fund. In March 1994 CAF (a company controlled by the Korsten Brothers) gained control of AMK, the then participating employer in the fund. AMK then appointed van der Linde de Villiers as actuaries, consultants and administrator to the fund. Van der Linde de Villiers then gave Old Mutual notice of discontinuance with the intention for the fund to operate in future as a privately administered fund. At the same time, they applied to the Financial Services Board for consent for the fund to invest in AMK. This required an exemption under section 19(4) allowing investment in the

employer. The FSB responded clearly indicating that an exemption from section 19(4) would only be granted once the fund converted to a privately administered fund and the exemption arising from its underwritten status was withdrawn.

11. However, before the rules and the withdrawal of the exemption were finalised, Old Mutual in December 1994 transferred more than R32 million directly to CAF the employer on the strength of the letter received from van der Linde de Villiers. Old Mutual did not seek the approval from the Registrar for these payments, nor did it advise the Registrar of the discontinuance of the policy or the payments made. The rule amendments eventually went through in June 1995 and the exemption was withdrawn resulting in the fund converting to a privately administered fund at that date. Subsequently the company went bust and the amounts which had been paid to the employer became irrecoverable by the pension fund. For that reason, the curator sought relief against Old Mutual.

12. In the High Court the matter came before Blignault J. He dismissed Mostert's claims and granted judgement in favour of Old Mutual. He assumed that the fund had been a party to the insurance policy, but rejected the claim in contract on grounds that the fund had acquiesced in the payments made to the employer in breach of the policy. He further held that although in making the payments to the employer Old Mutual had acted in breach of a statutory duty as well as negligently, the required factual causation between Old Mutual's conduct and the loss suffered by the fund was lacking.

13. The Supreme Court of Appeal made several important findings in this matter and pronounced definitively and usefully upon the legal relationships arising out of the arrangements normally undertaken in respect of

underwritten pension funds. First of all, it held (contrary to the arguments of Old Mutual), that the fund had legal personality and that the assets vested in the fund in terms of section 5 of the Act were invested in terms of the policy and comprised claims by the fund against Old Mutual. While the fund, being underwritten, could not itself hold any money in terms of the rules it followed in both logic and law, that the fund, clothed as it was with legal personality and a capacity to contract, would inevitably be a party to any insurance policy underpinning its investment. Even though the contractual relationship between the fund and the insurer would have been forged by the employer as the proposer, normally the employer would be acting in two different capacities *qua* employer on the one hand and *qua* proposer on behalf of the fund on the other. In this way privity of contract between the fund and Old Mutual would have come about. Consequently, because the fund was a party to the policy it was entitled to enforce its rights under it, which would include a claim for damages arising out of its breach.

14. The learned judge then went on to investigate whether Old Mutual had acted in breach of the policy. In this regard he held that it was an implied term of the policy that Old Mutual would be obliged to comply with all the statutory requirements, as well as the provisions of the rules of the fund.

15. In terms of clause 3.10(2) of the policy. In the event of discontinuance the aggregate credit balances had to be paid within one month for the benefit of members "to such approved fund as the proposer shall direct". Consequently AMK's instruction to Old Mutual to pay the credit balances to CAF was not a valid directive, and could not bring about a valid discontinuance of the policy for the following reasons:

- CAF was not an approved fund let alone the underwriter of such a fund;

- CAF was not entitled to receive any monies on behalf of the fund because the fund was not entitled to hold any monies for as long as it was underwritten;

- CAF could not in law have become the investment manager of the fund for so long as the fund remained underwritten and its rules remained unaltered;

- Payment to CAF took place without the permission of the Commissioner of Inland Revenue; and

- What occurred was no more than an invalid purported compliance with an invalid directive.

16. Consequently Old Mutual had breached the provisions of clause 3.10(2) of the policy and its underlying contract with the fund. Old Mutual should have refused to pay because the instruction given required it to act in breach of its contractual obligations.

17. In the High Court Blignault J had dismissed the claim for breach of contract on the grounds that the fund had acquiesced in the payments made by Old Mutual to CAF. While the Korstens owned and controlled AMK, and hence CAF, at the same time Laurie Korsten was the directing mind and will of the fund. Through him, it was argued, the fund was aware that the payments had been instructed, made and received, consequently it had acquiesced in the state of affairs and could not rely upon the payments as constituting a

breach. The Supreme Court of Appeal rejected this argument for the following reasons:

- Acquiescence was never raised as an issue on the pleading nor fully ventilated at the trial. Being akin to a waiver it needed to be raised in order to be relied on.

- The fund could not lawfully have acquiesced in or be bound by what was an invalid directive because it had no power in terms of the rules to do so.

- In giving the discontinuance instructions to Old Mutual, Laurie Korsten was not acting on behalf of the fund but on behalf of AMK only. It was common cause that the Korstens were anxious to get hold of the funds money for the benefit of their company.

- Laurie Korsten was not acting in good faith for the benefit of the fund and cannot be taken to have acquiested on its behalf. He devised a scheme which resulted in payments made to CAF contrary to the conditions of the exemption, the policy and the rules, with no benefit to the fund or its members. Thus he was not acting in the field of operation assigned to him and should not be considered to be the directing mind and will of the fund.

18. In conclusion, the Supreme Court of Appeal scathingly dismissed other arguments by Old Mutual described variously as somewhat breathtaking and cynical. The offending argument was that there existed a practice which had superseded the law, in terms of which the rules and registered status of a fund could be altered by an employer without any formal amendment of the rules and without registration of any amendment. The

gist of the argument was based on the fact that the office of the Registrar, is understaffed and is required to deal with a great number of funds. If it were to operate according to the prescribed statutory requirements there would be inordinate delays. In order to cope with the inconveniences, a practice has evolved to which the Registrar's office is a party in terms of which informal amendments effected by the employer are treated as having full legal effect, without submission to the Registrar and without registration by him. In other words, it was argued that even though the rule amendments converting the fund to a privately administered fund had not gone through, the fund should be considered as such in anticipation of the Registrar eventually getting round to the rule amendments. This exasperating argument has been presented to me by various administrators over the years. One can only welcome the Supreme Court of Appeal's decisive rejection of it as particularly satisfying. Essentially it amounts to an argument that we should obey the law only when it suits us. When one hears arguments of this kind at this level one despairs at ever arriving at a culture in South Africa where the law is considered as sacrosanct and worthy of obedience.

19. Another important decision handed down by the Supreme Court of Appeal recently is that of *Associated Institutions Pension Fund v Le Roux*. This is the case concerning the mass transfers of members out of the Associated Institutions Pension Fund to various autonomous funds established by the universities and similar institutions.

The applicants were the employees and pensioners of the University of South Africa who along with 35000 other persons from 65 government funded institutions elected to leave the fund in 1994-5 to join funds established by their own institutions. As is well known, the transfers took place in a deficit situation and members moved with approximately 60% of

their actuarial liabilities. It subsequently transpired that the calculations were not entirely accurate and several attempts have been made in various forums throughout the country to redress the situation.

My office ruled early in 1998 that by virtue of the provisions of the Pension Funds Act we lack jurisdiction in relation to this fund. As far as I know, proceedings have been launched in the Natal High Court, the Transvaal High Court and here in Cape Town. The decision of the Supreme Court of Appeal reverses the decision of the Transvaal High Court setting aside the actuary's determinations.

In terms of transfer regulations promulgated in April 1994 each member and pensioner was entitled to be credited with an amount "equal to the funding percentage multiplied by the actuarial obligation of the fund in respect of that member as determined by the actuary on the date of which his membership of the fund is terminated".

The reason for requiring the funding percentage to be determined, was that the fund had been consistently underfunded since 1985 with the result that the departing members could not be paid 100% of their actuarial reserve values. In April 1995 the actuary in question determined the funding percentage as at November 1994, being the departure date, at 60.8%.

In view of difficulties in ascertaining the exact number of fund members as at November 1994, the actuary in calculating this aggregate actuarial obligation applied what he termed a "data loading factor" of 7.5% to its membership. This entailed an increased provision of possible unascertained members and thus increased the fund's actuarially calculated liabilities. This in turn resulted in an appreciable reduction of the sums transferred for the benefit of the applicants when the assumed liabilities were matched with

the assets. The reason for the inaccurate membership data was that the associated institutions were not obliged to render accurate membership returns to fund, and obtaining such data had proved impracticably difficult for the fund.

In subsequent valuations the actuary reduced the data loading factor by two-thirds to 2.5% and this yielded a funding percentage of 66%, 10% higher than the valuation applied at the transfer date. Later valuations on a ongoing basis reflected the funding percentage at 84.3%.

20. In the High Court Southwood J concluded that the actuary when determining the fund's actuarial obligation was required to effect a mathematical computation based on reliable data. In other words, he held that the actuary should have waited until accurate membership figures eventually became available. Accordingly, he set aside the actuary's determination.

21. When the matter went to the Supreme Court of Appeal Judge Edwin Cameron in a remarkably deferential judgement held otherwise and reversed the decision. With reference to the language of the transfer regulations, he stated that an appreciation of the actuarial function was fundamental to a proper understanding and application of the regulations, and that they contemplated, authorised and required the employment of actuarial expertise and skill in calculation of the transfer values applicable to the applicants. These he said were intended to imbue the determining function with attributes of professionalism and skill peculiar to the field of actuarial expertise.

22. In the circumstances facing the actuary at the time, Judge Cameron felt that the actuary was impelled to act in April 1995 and could not wait for

more accurate membership figures to become available. Hence, he could effect his calculations only by making provision for all contingencies which might reasonably effect the calculation. His duty included assessing the fund's total membership on the information available to him at the time. He owed the duty as much to those who chose to stay in the fund as to those who chose to go; and the fact that the result proved in the longer run to the advantage of those who stayed and to the disadvantage to those who left cannot invalidate his assumptions at the time they were made. While "later-acquired wisdom" showed that a higher percentage, calculated perhaps less prudence and with less caution, would have matched the facts as subsequently revealed. This did not mean that the actuary had erred. By employing the methodology appropriate to what the regulations required of him, the actuary acted properly and lawfully at the time he made his determination. There was also no suggestion that the assumptions he had employed were inappropriate or unreasonable.

23. While the judgement adopts a reasonably sensible and deferential approach to the question of actuarial expertise, in my respectful view, it sets the standard for actuarial discretion too low and offers too great a comfort zone to actuaries. The test applied is essentially one of rationality and implicitly advocates a non-interventionist approach.

24. Had one applied the principle of proportionality sanctioned by the Bill of Rights the outcome could have been somewhat different. Proportionality looks at the connection between the means of discretion and it purpose and in particular assesses whether more suitable alternative means could have accomplished a less disproportionate effect. The actuary could have acted more proportionately had he simply allowed for an initial provisional transfer and committed himself to an agteskot payment in the event of his data

loading factor proving to be too conservative, as was indeed the case. Greater justice would then have been done.

25. Another case of the Cape High Court relating to one of our own determinations is *Old Mutual Staff Retirement Fund v the Pension Funds Adjudicator*. This is the appeal in the *Greenwood* matter.

26. It will be remembered that the complainant early in 1998 obtained a quotation of his retirement benefit for an effective retirement date of 1 November 1998. His estimated accumulated credit was set at about R1.2 million. In September 1998 he was supplied with a revised quotation which quoted a low figure, some R170,000.00 lower than the first figure. Upon enquiring for the reasons for the difference the complainant was informed that it was solely due to a change in the interim bonus rate, which stood at 12% of the time of the first quote to 0% in September 1998. The complainant argued that the change of interest rate was *ultra vires* because the rules restricted the management board to declaring a prospective interest rate once a year at the financial year-end. In our view, the wording of the rules supported the argument. The respondent was aware of the difficulty posed by the language of the rule and sought to rely upon a practice within the fund whereby the interim rate was not guaranteed for any period and could be changed at any time.

27. On appeal before the High Court, Judge Davis agreed with the fund and set aside our determination. His judgement offers an interesting excursus into the method of interpretation albeit at times somewhat obtuse and academic. Despite his lengthy discourse on, he ultimately decides the matter on a prudential basis. Thus he says:

> For rule 1.22 to be construed as constituting a prohibition against any variation of an interim interest rate until the next final declaration regardless of whether the market had declined dramatically, would result in the management board of applicant being forced to stand idly while the stock-market plummeted and the future of applicant was placed in jeopardy on account of interest rates being employed to effect benefit payments which bore no reflection to the actual return which could be received by applicant.

28. While one obviously has some sympathy for such concerns, the reasoning is fraught with danger and mirrors the argument of Old Mutual in the *Mostert* matter. Essentially it comes perilously close to saying that despite what the rules say, and irrespective of the rights of the members, if the fund runs into financial difficulty because of bad governance and investment planning, it can make ad hoc adjustments even though its rules do not allow it to do so. When the rules become inconvenient we shall simiply ignore them and adjust our practices to meet our financial comfort.

29. As we have demonstrated in other determinations, many, if not most, defined contribution pension funds wisely include a power in terms of their rules to adjust interim interest rates on an ongoing basis. The fact of the matter is that the rules of this matter did not and what was required was an amendment to the rules to allow for the necessary adjustments. In effect, what Judge Davis has done is sanction a practice not strictly authorised by the rules in the interests of financial expediency.

30. Moreover, the learned judge fails completely to deal with the finding in our final determination that the respondent had produced little evidence of the consequences that would be experienced by the fund and its remaining members, and the fact that we upheld the complainant's argument on the basis of evidence submitted to us that the prejudice which might be caused to the fund and the remaining members was minimal in relation to the

prejudice which had been suffered by the complainant and other exiting members. And finally, the learned judge's concerns about a looming financial disaster failed to take into account that a rule amendment was all that was required to solve the problem for the future. I gather this matter may be taken on appeal and one waits optimistically for the Supreme Court of Appeal to maintain its track record following both *Mostert* and *Tek* reminding us, as they both do, that the rights of members are best determined by the rules rather than dubious practices.

Surpluses, Fund restructuring and section 14 transfers

31. Recently we have handed down a number of decisions dealing with questions of surplus and section 14 transfers. Where the disputes arise out of agreements or the rules the law governing entitlements is fairly clear. The difficulty usually arises in those complaints which contest the reasonableness or fairness of transfer values.

32. In *Barnard & Other v Langeberg Food Pension Fund* I held that former members of the fund who had been retrenched or resigned and had been paid their withdrawal benefits had no rights in law to share in a surplus distribution some years after their departure. The complainants had all been paid the amount of their actuarial reserves either in the form of a cash payment or a transfer to preservation funds.

33. Shortly after their withdrawal, the fund commenced a process of restructuring resulting in the creation of a defined contribution section of the fund and the outsourcing of pensioners to annuities with an insurance company. Active members who transferred to the defined contribution section received a transfer value of their actuarial reserve plus a 40% enhancement. The complaint was in essence that the board of

management ought to have included them in the category of persons entitled to an enhancement.

34. The fund naturally maintained that upon withdrawal for reasons of redundancy or resignation, each complainant received the benefits due to him/her in terms of the rules. At the time the fund was restructured, the complainants had no rights in relation to the fund and could not have entertained any legitimate expectations which were impaired or infringed thereby. The board was under no duty, either in terms of the Act or the rules, to consider making an enhancement for the benefit of the former members who had withdrawn from the fund and who had received what was owing to them in terms of the rules.

35. The complainants placed some reliance upon certain pronouncements I had made in *Euijen v Nedcor Pension Fund* where I held that the distribution of part of the surplus to former members of the fund, who were still employees of the employer, was not inconsistent with the expressed object of the fund to provide benefits to the employees of the employer. However, it did not follow from such a finding that former members who have received all of their benefits and who no longer are in the employ of the employer automatically have any rights or expectations to share in the assets of the fund. The restructuring arrangements in the *Euijen* matter were part of an ongoing scheme and the finding was limited to the conclusion that the trustees had not exceeded their powers. Moreover the *Euijen* decision was handed down prior to the Supreme Court of Appeal in the *Tek* matter, and to the extent that the impression has been created that all former members have significant rights to share in the surplus, this must be seen as qualified by the pronouncement of the Supreme Court of Appeal that entitlements are determined primarily if not exclusively by the rules.

36. *Whelan v Babcock Africa Pension Fund* demonstrates that timing can be everything in restructuring arrangements. Until 31 October 1995 the complainants had been employed by Babcock in the acid waste regeneration business of its Metsep division. On or about 13 November 1995, Babcock sold the acid waste regeneration business of its Metsep division to a company which became known as Metsep SA (Pty) Ltd. The effective date of the sale was 1 November 1995. Each of the complainants accepted employment with Metsep and ceased to be employed at Babcock at that date.

37. On taking up employment with Metsep, each of the complainants was afforded an election to transfer his or her pension interest from the fund either to the SACWU Provident Fund or to the Superflex Pension Fund. However, an agreement between Metsep, the fund and Babcock allowed the complainants to remain as contributing members of the fund for a period of 12 months which was subsequently extended until the new pension fund arrangements had been finalised. Various other decisions extended the time period until the Registrar issued section 14 certificates on 16 October 1997 in respect of the Superflex transfers and another one on 18 March 1998 in respect of the SACWU transfers. In both instances the section 14 retrospectively set the effective date of transfer at 1 November 1996. However, the pension interests of the complainants were only transferred some time later in January 1998 and May 1998.

38. During 1996 – 1997 the fund decided to restructure with a view ultimately to winding-up. The then members of the fund, but not the complainants, were given an election either to remain as members of the fund or to become members of a new defined contribution fund. Those members who elected to transfer received their actuarial reserves together with an enhancement of 24%. The few who opted to remain with the fund were

later transferred to an umbrella fund with similarly enhanced transfer values. However, the board refused to consider the complainants as members and declined to enhance their transfer values even though these had not been finalised.

39. Again, as in Barnard, there was no challenge to the methods and assumptions applied in calculating the members' actuarial liabilities. I agreed with the complainants that they were members of the fund until such time as their transfer values were actually transferred to the transferee funds on 7 January 1998 and 13 May 1998 and that consequently they remained members at the time when the final decision of the board effecting the appropriation and distribution of the surplus was taken on 1 October 1997 and the board of management voted to agree to the employer's proposal that the surplus would be distributed on a 50/50 basis between the employer and the members.

40. In terms of the legislation membership of a pension fund does not cease until such time as the member has received all benefits which may be due to him from the fund and his membership thereafter has been terminated in accordance with the rules of the fund. Hence, in the face of their continued membership, I was satisfied that the complainants were entitled to share in the surplus distribution as part of their entitlement to received a reasonable and equitable transfer values.

41. An analysis of the surplus revealed that it was generated mainly from fund earnings in excess of the valuation rate of interest and from early withdrawal profits, and that these were to some extent were set off by salary and pension increases.

42. Moreover, it was important to keep in mind that the distribution of the surplus occurred as part of a scheme by the employer to restructure its pension obligations, with a view to then terminating the fund entirely. In a winding-up situation the board of management can be expected to observe a high standard and has a duty to assess how the respective interests of different stakeholder in a fund have been catered for out of the surplus generated over the preceding years. The enquiry is whether the board, with reference to the history of the fund, struck a fair balance between any benefit approvements awarded to members and the contribution holiday enjoyed by the employer. The evidence suggested that the board had made no real attempt to strike this balance and in fact the board appears to have accepted the employer's proposal for distribution somewhat uncritically. Nevertheless, there was some consultation with membership and there were indications that the proposal enjoyed support of 90% of the membership. Nevertheless I felt that I had insufficient information at my disposal to fashion an appropriate remedy and postponed the matter until the parties submitted further information.

43. In two matters in which we have handed down preliminary determinations we have extended members rights to share in the investment reserve in transfer situations. We have been encouraged in this regard by the proposed surplus legislation in which a concession has been made that in many instances it is unfair not to grant some entitlement to the investment reserve to members and defined contribution funds who face the volatility of the market.

44. In *Spear v IBM SA 1994 Provident Fund* the complainant sought an order directing the fund to transfer a portion of the member's reserve account for his benefit to the fund which had been transferred pursuant to a section 14 transfer of business. Prior to 1994 employees of IBM were members of a

defined benefit pension fund, the IBM Pension Fund. In March 1994 the employees were given an option to move to a defined contribution and provident fund. In respect of each member who elected to transfer an amount representing his actuarial reserve value was credited to this fund credit in the new fund, without any surplus enhancement. However, from the surplus in the defined benefit fund, an amount representing 25% of the aggregate actuarial reserve value of all the transferring members was transferred to the provident fund and credited to a reserve account to be used exclusively for fund expenses and benefit increases. A further amount was also transferred from the surplus for the exclusive benefit of the employer.

45. Over the following years the reserve account for expenses and benefit increases was augmented by investment returns and profits consequent on early withdrawals by members of the fund. But was also depleted by distributions in favour of the members in respect of the years in which the fund earned low or negative returns due to poor investment performance. The amount standing to the credit of the reserve account at the end of 1999 was approximately R52 million.

46. In 1999 the complainant was forced to transfer out of the IBM fund as a result of the sale of the division in which he was employed resulting in the transfer of his contract of employment. He transferred along with other members out of the IBM Provident fund to the newly established Penlink Provident Fund.

47. Pursuant to his transfer, the complainant received his full credit but no part of the reserve account was added to his transfer value. He claimed that he was entitled to a portion of the reserve account to act as a buffer against the vagaries of investment performance.

48. On examining the nature of the reserve account, it was clear to us that the account was set up for the exclusive benefit of members. This was apparent from the following factors:

- the origin of the account – it was funded by a 25% enhancement and actuarial values of the members who were transferred from the original IBM Pension Fund;

- the purposes specified in the rules for the application of the funds in the reserve account;

- the historical record indicating that the fund had been used to augment member benefits;

- the fact that the employer enjoyed exclusive access to its share of the surplus in another reserve account, deriving from the surplus in the previous fund, which it used to finance a contribution holiday.

49. From this we concluded that the employer had no direct financial interest in the reserve account and that the account existed primarily, if not exclusively for the benefit of members.

50. In other words, this was not an instance in which we were dealing with a notional surplus in a defined benefit fund. Rather we were dealing with surplus which had crystallised in a defined contribution fund and in respect of which rights had been more clearly formulated. Moreover, by apportioning the surplus in the way we proposed, we did not in any way

prejudice ongoing members who would still continue to have the benefit of their pro rata share of the reserve account for benefit improvements and increased costs. Accordingly, we held that the failure to enhance the transfer value by a proportionate share of the investment reserve in the circumstances fell short of the duty to ensure that the transfer scheme afforded full recognition to the rights and reasonable benefit expectations of the complainant. However, fully mindful of the controversy we chose to hand down a preliminary determination in this regard and are awaiting further argument.

51. In *Du Preez v Joint Municipal Pension Fund* we issued a rule nisi calling upon the parties to show cause why the failure of the respondent to enhance the complainant's transfer value by including his proportionate share of the investment reserve as part of his transfer value which should not be declared unreasonable, inequitable or in breach of the fiduciary duties of the board. The fund in this instance is a defined benefit fund. The transfers to which the complaint relates were a series of complex transactions as part of the restructuring of the Gauteng Local Authority Funds. Initially the complainant transferred with his actuarial reserve value. However, the fund to which he transferred subsequently negotiated an agreement and additional assets were transferred to it in the form of agteskot from reserves that were not included in the original transfer values. At a later date the complainant transferred yet again, but this time to the IMATU Retirement Fund. The complainant then did a comparison between his benefits and those of a colleague who had remained in the original fund before transferring to the IMATU fund. Despite the fact that his colleague was of the same age, had the same period of service and was paid an almost identical salary, the colleague's transfer value into the IMATU fund was approximately 27% more amounting to some R350,000.00.

52. The actuary justified the differential primarily on the grounds that there had been a change in the valuation basis in the original fund as well as benefit improvements. These factors together increased the actuarial values of the members who remained behind in the original fund by more than 20%. The complainant's response was that the benefit improvements were only possible because of the improved situation that existed as a direct result of the transfer of members out of the fund, without their full share of the investment reserve.

53. The original transfer values consisted of their actuarial reserve values on the projected unit method, which does not take into account any reserve or surplus. However, the failure by the board to take account of the investment reserve at the time was off-set to some extent by the payment of agteskot after the event.

54. After careful actuarial analysis, it was revealed that members in the position of the complainant had only benefited from 42% of the proportional value of the reserve attributable to their actuarial reserves. The reason for this was largely because after the original transfers out of the fund the board found that there was a large surplus left in the fund, they then introduced extensive benefit improvements for the remaining members. By the time the fund was approached to pay an agteskot in respect of the transfers, the fund, having utilised the surplus, was not in a position to transfer a fair proportion of the investment reserve. This fact alone cannot however, absolve the fund of liability. In our view, the board of management may have breached its statutory duties by failing to take account of whether or not the transferring members' reasonable benefit expectation was met before it gave consideration to utilising the surplus for benefit improvements for the remaining members. This failure obviously was

ameliorated by the payment of the agteskot. Thus, we have issued a preliminary ruling calling on the fund to show cause why a proportionate share of the investment should not be added to the complainant's transfer value.

Housing loans

55. The decision in *Khambule v CNA (Pty) Ltd & Others* is a salutary reminder to funds to observe caution when extending loan facilities for housing. As is well known, section 19 of the Act permits funds to grant a loan to a member to enable the member to either redeem a housing loan or to purchase a home or make additions and alterations. The employer and fund in this matter had a rather strange procedure for processing housing loans. Once members had located a suitable house or housing development, they would apply for a housing loan from their provident fund administrator by way of a housing loan application form. On approval of the application for the housing loan, a cheque would be issued by the fund for the member clearly marked "not transferable". The member would acknowledge his/or indebtedness to the fund by signing a surety document and giving an undertaking to effect repayments to the fund. Thereafter, for some reason not entirely clear, the cheque would be handed to a housing consultant who had some association with the employer and carried on a business under the name of Henmont Investments. In terms of an agreement between the employer and the housing consultant, the cheque, although marked "not transferable" would be endorsed by the member and made payable to Henmont. Apparently Henmont had some arrangement with ABSA Bank Limited in terms of which such endorsed cheques were deposited into the bank of Henmont despite the fact that they were marked "not transferable".

56. This is what happened to the complainant. Once he had found a house, he applied for the loan, the cheque was issued and he endorsed it over to Henmont Investments although he claimed that he did not know that that was in effect what he was doing. Sometime later, the transfer fell through because the seller did not have proper title. The R25,000.00 held by Henmont was never refunded to him. Subsequently, Henmont has been placed into liquidation and the complainant as well as other members have not recovered any of the monies. Despite that, at the time he lodged his complaint amounts were still being deducted from his salary for repayment to the fund.

57. There was some uncertainty about the legal relationship between the employer and Henmont. Henmont initially received a retainer from the employer but subsequently charged a flat administration fee of R550.00 to process each members' application. It is not clear what benefit the member received in exchange for the fee, and one is compelled to enquire why the matter could not have been better processed by the provident fund administrators.

58. It is both legal and desirable that pension funds be permitted to make loans to members for housing purposes. However, appropriate safeguards should be built in to the process. Where the fund grants a loan to the member as provided for in terms of section 19 in the fund's rules it is the fund rather than the employer that has the responsibility for administering the scheme. Thus while the employer may be involved in the scheme, the administration of the scheme falls within the general ambit of the object of a board requiring the board to act in accordance with its statutory and fiduciary duties.

59. Neither the Act nor the rules lay down specific procedures relating to the application for an approval of a loan other than setting the requirement that the loan itself must be for housing purposes. Most importantly the board of the fund has a duty to take all reasonable steps to ensure that the interests of the members are protected.

60. Reasonable steps require at the least that the board should satisfy itself that the money advanced will be used for the purpose for which it was intended and should build in safeguards to ensure this by enquiring and satisfying themselves as to the process of the payment of the loan monies to the seller or developer or contractor of the party concerned, ensuring by means of appropriate safeguards that there was no possibility of the monies being disbursed to any third party. The most obvious practical safeguard would be to require that the finances relating to the property transactions are held in trust in an attorney's trust account, thereby affording the member the protection afforded by the attorneys' fidelity fund.

61. In this instance, the trustees of the fund did not do any of these things. While the interests of the fund were secured by means of the member's pledge, (deductions continue to be made from the salary), the interests of the member were not protected by the trustees. The fact that they knowingly allowed Henmont investments to operate as they did allowing members to pay "non transferable" cheques into Henmont's bank account exacerbated their dereliction of duties. The possibility of the default by Henmont and the loss this would entail for members who were unprotected from its was always present and the fund should have taken steps to remove this possibility. Accordingly, we have issued a rule *nisi* calling on the respondents to repay the salary deductions and to increase the members credit by the R25,000.00 paid to Henmont.

Preservation funds

62. The saga concerning the entitlement of preservation funds members to a single withdrawal is ongoing. The confusion arises largely from the failure to appreciate the status of pension fund rules in relation to practice notes issued by the South African Revenue Services.

63. Paragraph 5 of RF 1/98 in its amended form provides that no more than one withdrawal benefit may be paid by the preservation fund prior to the member reaching the age of 55. It also provides that any amount deducted from the translocation benefit should be regarded as the member's first and final withdrawal benefit from the preservation fund. However, what funds, employers and SARS fail to recognise is that the rules of the preservation fund in this regard are determinative of the member's entitlement. In other words, if the rules are at variance with the SARS practice note, the rules prevail. We have made this point more than once and had cause to do so again in *Murray v the Wealth Builder Pension Preservation* Fund. The complainant was initially employed by Southern Life until his retrenchment entitling him to an early withdrawal benefit from the fund. He consulted with his employer and his own financial advisor and opted to transfer his withdrawal benefit to the preservation fund. He elected to take a cash benefit of R82,000.00 and the balance of about R250,000.00 was transferred into the preservation fund. The complainant maintains that he was under the impression, by virtue of the advice given to him, that he was entitled to a further withdrawal from the preservation fund some time in the future. When he sought to exercise that right, the fund refused the request on the strength of practice note RF1/98.

64. Rule 8.10 of the preservation fund grants members rights to make a withdrawal. The rule provided that the member shall be entitled to his

benefits prior to his 55 birthday. The benefit entitlement was explicitly limited to one withdrawal prior to retirement and provided that no further withdrawals would be permitted. It further provided that the member's entitlement was limited to the value of his investment and subject to any restrictions that the employer may have imposed on the employer contributions where the member elects to withdrawal partially or completely. There is nothing in the rule including a deeming provision stating that withdrawal prior to transfer in the preservation fund would constitute the single withdrawal as contemplated by the rules. In other words the rules were not consistent with RF1/98. Hence, notwithstanding the fact that the complainant had not transferred his entire withdrawal benefit over to this preservation fund, the rules permitted him to make a single withdrawal from his investment account. Insofar as the rules failed to comply with the directives of the SARS that is a matter between the fund and the SARS.

Admission to membership

65. We are beginning to pick up problems regarding admission to membership particularly in umbrella funds. The difficulties seem to be of consequence of the tension between member's rights and the practical constraints of administering funds of an umbrella nature. One wonders whether umbrella funds might not be better served by legislation which specifically caters for the umbrella arrangement.

66. Two cases illustrate some of the problems. In *Sekele v Orion Money Purchase Pension Fund* the complainant discovered on retrenchment after 8 years of employment that the employer had not made any contributions on her behalf to the Orion Pension Fund. She sought an order from us directing the employer to pay the contributions which ought to have been

paid during the period of her employment and an order directing the fund to pay her retrenchment benefit in terms of the rules. The fund conceded that the complainant qualified as a member, and accepted that the employer should have paid contributions on her behalf. Nevertheless, it argued that the mere fact that she was a member did not mean that the complainant had an automatic right to receive a benefit. It maintained that as no contributions were received in respect of the complainant, her accumulated value was nil and no benefit could be said to have accrued to her.

67. In our view, the payment of any benefit from a pension fund is regulated by the fund's rules. The rules determine the benefit without any reference to contributions. In terms of the master rules, it was compulsory for her to be a member of the fund until her retrenchment. We felt it was incumbent on the fund to collect the contributions payable and to ensure that its records corresponded with those of the employer. The failure of the employer to pay the contributions, whilst placing the fund in a difficult financial position, did not exonerate it from paying the benefit. Accordingly, we ordered the fund to pay the benefit, but also joined the employer and ordered it to pay the amounts outstanding to the fund.

68. In other words, we are of the view that it was not sufficient for an umbrella fund to sit back passively and rely exclusively on information furnished to it by employers. It is essential that some system of checking be introduced. The fund chose simply to rely on correspondence and on the employer initiative to notify it of any new members of the fund. Bearing in mind the substantial income which Old Mutual Employee Benefits derives from its administration of the fund, in excess of R20 million last year, I fail to see why employer cannot be required to furnish the fund administrators with a copy of their payroll at least on an annual basis, so that the data forwarded

by the employer to the fund can be checked. Alternatively, the funds need to find some arrangement whereby membership is not compulsory and automatic.

69. The rules of the Orion fund are quite clear and that is that all persons who become eligible employees after the participation date are obliged to participate in the fund. The act of entering into employment brings with it membership of the fund. Although the fund originally conceded that the complainant was in fact a member of the fund, in its application to the High Court in terms of section 30P it has suggested with reference to the peculiar nature of the umbrella fund that there was an obligation on the employer to register the complainant as a member. There may be some wisdom in such an arrangement, but either the special or master rules must provide for a process of registration of a member.

70. Another situation in which we can see the umbrella fund straining to regularise its arrangements on questions of membership is in *Nxumalo v Central Provident Fund*. The complainant was the spouse of a deceased member who sought to obtain death benefits under the fund. The fund refused to pay the benefit on the grounds that the deceased has failed to undergo two medical tests for the purpose of an insurance policy required to secure his benefits under the fund.

71. As with all umbrella funds, the employer submitted a proposal for participation in the fund in October 1998, with an inception date of 1 November 1998. It commenced paying contributions from that date in respect of its employees including the deceased. In terms of the rules of the fund, an employee qualified for participation in the fund if he earned more than R3,000.00 a month and met the normal requirements of Sanlam insurance company to qualify for insurance under an individual life policy of

the class normally effected by the fund on the life of the member. Any policy issued in respect of a member was issued in the name of the fund for the purpose of securing the benefits payable to the member arising out of its membership to the fund.

On 13 December 1998, some six weeks after the commencement of the employer's participation, the deceased was murdered. At the time of his death he had failed to go for an AIDS test and a Cotenene test for the purposes of the insurance policy securing his benefits. Accordingly, when his widow sought to claim the benefits the fund repudiated the claim on the ground that cover had not been granted to the deceased on account of his failure to undergo the medical tests.

72. The approach of the fund misconstrued the nature of fund membership and tended to focus on the requirements of the insurance policy. The dependants of the deceased, in my view, were entitled to a death benefit in terms of the rules of the fund, provided the deceased was a member of the fund prior to his death. Although the requirements of the assurer might not have been finalised, the fund accepted membership contributions from the employer in respect of the deceased. In terms of rule 12 the employer obligation to pay contributions is explicitly only "in respect of each of its employees who is a member of the fund". Likewise, in common law, membership contributions or subscriptions are due only once membership has been accepted. Moreover, despite the absence of the medical tests, the membership contributions received by the fund from the employer were applied by the fund to meet its premiums in respect of a policy which had indeed been issued in the name of the fund. The acceptance of membership contributions is a strong indication that the fund had accepted the deceased's application for membership of the fund and thus the fund had waived its right to insist on the deceased meeting the requirements of

an individual life policy for the purpose of obtaining membership of the fund.

73. Any invalidity or defect in the insurance policy is a matter between the fund and the insurer. The dependant's claims arise by virtue of the deceased's membership of the fund. In the event of the insurance policy being invalid, the fund would be liable to the dependants for damages for maladministration on account of admitting the deceased to membership without first having underwritten his entitlement to the suite of benefits provided in the rules by means of an insurance policy. I am happy to report that subsequent to my ruling in this matter, the fund, the assurer and the complainant have been able to reach a satisfactory settlement.

74. In *Leak v Commercial Union of South Africa Staff Pension Fund* is another instance where admission to membership was the cardinal issue. In terms of the rules a member was defined as an employee who has been admitted to membership of the fund in terms of rule 10 and has not ceased to be a member under these rules. Rule 10 provided that every employee who was a member of the fund prior to 1 January 1987 shall remain a member of the fund an every other employee shall become a member from the date of becoming an eligible employee which was in turn defined to be a person who is on the permanent staff of an employer including a full time working director of an employer.

75. The complainant was offered a position as an administration clerk in September 1993. In the course of negotiations with the employer the usual company benefits, including membership of the pension fund, were discussed with her as was the standard company procedure of a medical examination. The complainant accepted the offer and terms discussed including the benefit of membership of the pension fund. Thereafter she

went for the medical examination and commenced her employment on 1 October 1993. When she eventually received her letter of appointment no mention was made of the pension fund and when she made enquiries she was advised that she was not fit on medical grounds and was declined membership of the pension fund. Her medical condition was slightly raised blood pressure and a family history of high blood pressure. The complainant sought to have her grievance rectified but never succeeded. She consistently took the view that she was unlawfully prevented from becoming a member of the fund and sought to obtain compensation. At the time of her retrenchment, the dispute crystallised further and the company took the position that although she had been employed for some 6 years she was never permanent member of staff and was thus not an eligible employee entitling her to a membership of the fund.

76. We felt that although the complainant had been referred to as a temporary employee, the true intention of the parties was to appoint her on a permanent basis without the benefit of pension fund membership. Her designation as a temporary employee was no more than a method to avoid entitlements to which she was otherwise entitled. There was clearly no intention to employ her for a limited purpose or a limited time.

77. The reason she was employed on a so called temporary basis was due to her failing medical examinations which the employer maintained was necessary in terms of the pension fund rules. However, nowhere in the rules of the pension fund did it state that an employee had to pass a medical examination in order to qualify for a permanent position. The complainant was employed under exactly the same conditions as permanent staff in her department. Her duties were exactly the same as they would have been had she been permanent and there was no fixed term contract. In fact, five and a half years after her appointment the complainant was still

in the employ of the employer, heading the administration department with 8 staff members reporting to her. Hence, she was clearly eligible for membership.

78. The question is whether such eligibility rendered her automatically a member of the fund was answered with reference to rule 10 which provided every employee *shall* become a member from the date of becoming eligible. Hence, in terms of the rules of the fund the complainant was in fact a member of the fund. Again, that no contributions were paid in respect of her does not exempt the fund from paying the retrenchment benefit. The question of outstanding contributions would then be a matter between the fund and the employer and the employer could take steps considered necessary to claim unpaid contributions from the member.

Conclusion

79. Thus, you will see, the office of the Pension Funds Adjudicator keeps busy and continues to flourish meeting new and difficult challenges almost on a daily basis. With our planned expansion, we look optimistically to the future and to speeding up our clearance rate. Thank you as always for your time and listening to me.