

IN THE TRIBUNAL OF THE PENSION FUNDS ADJUDICATOR

CASE NO.: PFA/GA/5/98

In the complaint between:

A R Fondse and the Denel Aftree Regsfonds

Complainants

and

Denel Retirement Fund

First Respondent

Denel Pension Fund

Second Respondent

Denel (Pty) Ltd

Third Respondent

DETERMINATION IN TERMS OF SECTION 30M OF THE PENSION FUNDS ACT OF 1956

The complainant, Mr Adriaan Rudolph Fondse, is a member of the first respondent, a former member of the second respondent and an employee of the third respondent. He is also a member of a voluntary association of members and former members of the first and second respondent, known as the Denel Aftree Regsfonds, which has played some part in these proceedings. Both Mr Fondse and the Denel Aftree Regsfonds have lodged complaints with the Pension Funds Adjudicator in terms of section 30A(3) of the Pension Funds Act of 1956.

The first respondent (DENRET) is a defined contribution pension fund registered in terms of the Pension Funds Act of 1956. The second respondent (DENPEN) is a defined benefit pension fund registered in terms of the Pension Funds Act of 1956. The third respondent is the participating employer in both the first and second respondent.

The complaint of Mr Fondse (hereinafter referred to as the complainant) consists of three separate complaints. The first two complaints seek relief in relation to the division

of assets between DENPEN and DENRET subsequent to a restructuring in 1994. The third complaint seeks an order compelling the implementation of free investment options within DENRET.

An additional complaint was lodged by the complainant's attorneys, Messrs Willemse & Benadie of Pretoria, on behalf of a group of unidentified complainants, being members of the Denel Aftree Regfonds. These complainants endorsed the formal complaint lodged by the complainant and further complained that they were misled by certain alleged misrepresentations made to them during the restructuring exercise. In their complaint the unidentified complainants fail to specify the relief which they seek from the Adjudicator. In the proceedings before me, the complainants' representatives agreed to withdraw this complaint. Therefore, it is not necessary to discuss it further, other than to say that the Denel Aftree Regfonds shall be required to consent to the negotiated solution set out herein.

The process followed

A hearing was convened at the premises of DENRET and DENPEN on 14 September 1998.

The complainant was not formally legally represented but informally relied on assistance from his attorneys and a former colleague, Adv Theo Grobler. Various other members of the two pension funds were also in attendance.

The following persons were in attendance on behalf of the three respondents:

Ms	K Biggs	(Auditor and Pension Funds Specialist: Price Waterhouse Coopers)
Messrs	L de Witt	(Actuary, who was responsible for the actuarial division of asset between DENPEN and DENRET as at 1 September 1994)
	S B van der Merwe	(Attorney, Rooth & Wessels)

C K Foord	(Chairperson: DENPEN and Employer representative Trustee : DENRET)
P J van der Merwe	(Principal Officer : DENRET)
S N van Vuuren	(Employee representative Trustee : DENRET)
L P van der Merwe	(Employee representative Trustee : DENRET)

At the commencement of the proceedings, I drew the various parties' attention to section 30J(1) of the Pension Funds Act which provides as follows:

The Adjudicator may follow any procedure which he or she considers appropriate in conducting an investigation, including procedures in an inquisitorial manner.

I explained to the parties that this provision permitted me to adopt an informal investigative and facilitative process, rather than an adversarial adjudicative process. Such a view is supported by the provisions of section 30D of the Act which provides:

The main object of the Adjudicator shall be to dispose of complaints lodged in terms of section 30A(3) of this Act, in a procedurally fair, economical and expeditious manner.

Accordingly, I invited the parties to participate in a facilitated negotiation in an attempt to reach a resolution of the dispute by means of negotiation and mediation. It was agreed that should the facilitative negotiation fail to yield a satisfactory agreement, I would then adopt an adversarial adjudicative approach. In the event, the latter option has proved to be unnecessary at this stage and the parties were able to reach a satisfactory agreement, which shall form the basis of my determination of this complaint. However, in the interests of legitimacy, I have determined that this determination shall be effective only with the agreement of the Board of Trustees of DENRET, the Denel Aftree Regsfonds and the Divisional Pension Committee of DENRET (DIVCOM), an informal structure representative of member interests throughout the company and across the country.

As stated, none of the parties were formally legally represented. I met with the complainant and the respondents separately, and both made written and oral

submissions to me.

Background to the complaint

DENPEN was registered as a defined benefit pension fund on 30 October 1969, originally under the name of Krygkor Groeppensioenfonds. At that time, the participating employers were Armscor, a state corporation created by Act 57 of 1968, and its subsidiaries. Subsequent restructuring within the state arms industry resulted in the fund changing its name and the third respondent becoming a participating employer in the fund. DENPEN is managed by a board of trustees appointed by the third respondent.

In 1994, DENPEN, Denel (Pty) Ltd (the third respondent) and the representatives of the members of DENPEN entered into negotiations resulting in an agreement for the establishment of a new fund to be known as the Denel Retirement Fund (DENRET) which would basically be a defined contribution fund, although the death and disability benefits provided by the fund would be defined benefits. DENRET was registered on 8 December 1998 with effect from 1 September 1994. DENRET is managed by a board of nine trustees. Four trustees are appointed by the employer and four are indirectly elected by the members through a negotiating forum. The Chairperson is an outside non-member. Being a defined contribution fund, both the employer and the members in DENRET contribute fixed percentages of the members' salaries or wages. A member's benefit is then based on the value of his share of the fund, called his "share" or "share account". The value of his or her share is the accumulated value of his or her own contributions and the employer's contribution (after deduction from the employer's contributions of amounts apportioned to defray the costs of death and disability benefits and the operating costs incurred by the fund) plus the investment return on the contributions.

As part of the restructuring exercise, DENPEN became a closed fund with the result that new employees of Denel (Pty) Ltd since 1 September 1994 have automatically become members of DENRET. All pensioners as at 1 September 1994 remained in DENPEN.

Existing active, contributing members of DENPEN as at 1 September 1994 were given the option to remain in DENPEN or to transfer to DENRET. About 98% of the active members of DENPEN opted to transfer to DENRET.

Those members who opted to transfer had their member's share account in DENRET credited with an opening balance equal to his or her actuarial interest in DENPEN at the date of transfer. If this amount was less than double the aggregate of his own contributions plus interest, the opening balance of the share account was increased to this aggregate amount. In order to compensate members for the shift of the investment risk resultant upon the transfer into a defined contribution fund, the opening balance of each member's share account in DENRET was increased by 20% as a so-called "sweetener".

In addition to the actuarial interests of all the members transferring, a proportion of the net assets of DENPEN in the ratio the aggregate of the actuarial interests of the transferring members bore to the aggregate of the actuarial interests of the members and pensioners remaining in DENPEN was transferred from DENPEN to DENRET. The transfer surplus was first applied to enhance the opening balances to ensure that all members had at least not less than double the aggregate of their own contributions plus interest, as well as to credit their accounts with the 20% sweeteners. The remaining balance was then credited to various reserve accounts. The portion of the surplus applied to enhance opening balances was in the amount of R221 million or 21.1% of the total surplus transferred. The balance of R782 million or 78.9% was applied in the reserve accounts to provide for the following reserves:

- a risk reserve of R115 million (11.4%)
- a data reserve of R32 million (3.1%)
- a general reserve of R26 million (2.6%)
- an employer protection reserve of R300 million (29.9%)
- an investment reserve of R309 million (31.0%)

At the time of the division on 1 September 1994, the surplus in DENPEN amounted to

R1876 million (market value of assets R3829 million less liabilities R1953 million). As such, DENPEN was 196.1% funded at that date. On the above basis, R1003 million of the surplus was allocated to DENRET and was transferred to it. The remainder of the surplus R873 million remained in DENPEN.

The respondent contends that the surplus was divided proportionately between DENPEN and DENRET in the ratio the aggregate of the actuarial interests of the members of DENPEN who opted to transfer to DENRET bore to the aggregate of the interests of those members who remained and of the pensioners who remained. The complainant contests this.

All of the reserves in DENRET with the exception of the employer protection reserve of R300 million enure to the benefit of the members of DENRET. The risk reserve was created to provide a reserve in respect of the death and disability benefits payable under the rules of DENRET. The data reserve was created in case the records of DENRET should prove to be inaccurate resulting in claims not otherwise provided for. The investment reserve was designed to smooth out investment returns to be credited to the members share accounts.

The general reserve aims at providing for contingencies and obligations of the fund not covered by the share account or the pensions account. In practice this was created to provide funds for day to day cash flow needs. At 31 December 1996 the reserve was reduced to R2 million by transferring R30 million to the investment reserve. The bulk of the data reserve was also transferred to the investment reserve.

After certain negotiations during 1995, it was agreed to allocate the actual investment returns to members' share accounts without any smoothing. Consequently, the investment reserve no longer served a purpose and it was allocated to members' share accounts, and to increase pensions payable at the time, in two stages. Firstly, on 31 December 1995 when the reserve stood at R260 million, R130 million of this amount was allocated to the share accounts of members who were members and to pensioners who were receiving pensions on 31 March 1996. The effect was to increase the amounts of their share accounts and pensions as at 31 December 1995 by 7 %. On 31

December 1996 the reserve stood R204 million, including the portions of the data, risk and general reserve that have been transferred to it, and this amount was allocated among the members' share accounts and to increase pensions, at that date, increasing them by a further 11.5%.

The reserve account which is in contention is the employer protection reserve. The rules of DENRET provide that the employer protection reserve may be applied by the Trustees, at the request of the employer after consultation with the actuary, to meet the contributions due by the employer or to increase any benefit payable to or in respect of a member. As appears from the figures mentioned earlier, the amount allocated to this reserve at 1 September 1994 was R300 million. This amount has subsequently grown to more than R400 million. This was the only amount of the surplus allocated for the benefit of the employer and DENRET from the surplus transferred from DENPEN. It is this transfer which forms the main bone of contention between the parties.

The complaints about the division and application of the surplus

The complainant's first complaint is that the division of the assets between DENPEN and DENRET which took place with effect from 1 September 1994 is not reasonable and equitable as required by section 14(1) of the Pension Funds Act. In particular, the complainant submitted that the retention of an amount of R873 million surplus in DENPEN could not be regarded as reasonable and equitable in that such surpluses would not be required to provide for DENPEN's liability to pay future defined benefits for the remaining active members and pensioners. The complainant urged me to order the transfer of a portion of that surplus from DENPEN to DENRET.

At the commencement of the proceedings, I advised the parties that there were two difficulties with this complaint. Firstly, the Registrar of Pension Funds who had approved the transfer in terms of section 14 of the Pension Funds Act was a person with a sufficient interest in the matter, and was required to be joined as a party in terms of section 30G of the Pension Funds Act of 1956. Additionally, I advised the complainant that I wished him to address me on the application of section 26(2) of the Financial

Services Board Act, 97 of 1990 and its relationship to the complaints adjudication process established by Chapter VA of the Pension Funds Act of 1956. Section 26(2) of the Financial Services Board Act reads as follows:

Any person aggrieved by a decision of the executive officer under a power conferred or a duty imposed upon him by or under this Act or any other law may within the period and in the manner and upon payment of the fees prescribed by the Minister by regulation, appeal against such a decision to the Board of Appeal.

The Registrar's decision to issue a certificate to DENPEN to the effect that the requirements of section 14(1) of the Pension Funds Act have been satisfied, is a decision of the executive officer (the Registrar of Pension Funds) under a power conferred upon him by the Pension Funds Act, and therefore any appeal against such a decision arguably should be made to the Board of Appeal. The Registrar issued such a certificate in respect of the transfer of business from DENPEN to DENRET in 1994. The issue in the present case is whether the existence of the appeal remedy excludes the jurisdiction of the Adjudicator to determine a complaint about the Registrar's exercise of discretion.

In response to my concerns, and during the course of the negotiations aimed at resolving the complaint, the complainant agreed to withdraw this complaint. Accordingly, the negotiated solution forming the basis of this determination relates only to the second and third complaints of the complainant.

The second complaint concerns the employer protection reserve. The complainant submits that the crediting of the employer protection reserve with an amount of R300 million emanating from DENPEN was irregular and unauthorised by the DENRET rules.

In particular, DENRET rules 2.2(3)(c)(iv) and 2.2(3)(a)(vii) provides for an employer protection reserve as part of a reserve account, consisting of employer contributions in terms of rule 8.2(2) and investment earnings. Rule 8.2(2) provides that the employer may from time to time, in consultation with the actuary, make additional contributions to the fund in order to increase the balance in the reserve account. It is the complainant's submission that the amount transferred from DENPEN into the employer protection

reserve together with the income earned on it was not paid by the employer. On the contrary, it was part of the funds transferred from DENPEN, a different legal entity and not the employer. It follows, according to the complainant, that this credit was unauthorised and could not be allowed to stand. Accordingly, the complainant asks for an order crediting the full amount of the employer protection reserve to the individual members share accounts.

The respondents deny that the crediting of the employer protection reserve was irregular and unauthorised by the DENRET rules.

During the course of 1997 and 1998 there have been a series of negotiations between the employer and the members of DENRET regarding the utilisation of the employer protection reserve. In March 1998 the employer made a final offer that the reserve should be divided on the basis of 60% to the employer for the purpose of a contribution holiday in DENRET and 40% to be credited to the share accounts of the members who transferred from DENPEN to DENRET.

During the proceedings before me, it was finally agreed that the trustees of DENRET shall give effect to the request by the employer to divide the employer protection reserve on the basis of 60% to be applied by the employer as a contribution holiday and the balance (40%) to be transferred to the members' share accounts. The complainant was prepared to accept this offer only if the distribution of the 40% was to the share accounts of those persons who were members of DENRET at 1 September 1994 and thus would not include members who joined DENRET after that date. The relief granted hereunder gives effect to such agreement.

The third complaint: the free investment choices

The complainant maintains that at the time of the creation of DENRET, the members were advised that they would be allowed to exercise greater influence over the way in which the fund's assets were invested. The complaint is that the fund has failed to implement free investment options for those members who prefer to take a more active

role in the investment management of their individual share accounts. He, accordingly, requests me to order the implementation of a free investment scheme.

The respondents aver that the trustees have agreed in principle to implement a free investment option plan, once the outstanding issues between the parties have been resolved. At a meeting of the Divisional Pension Committee of DENRET on 3 September 1998 a sub-committee was appointed to investigate the matter further. The Board cautions that it is obviously important that members be educated in the complex questions that arise in such arrangements and that the appropriate administrative systems be in place before the plan is brought into operation.

In view of the agreement in principle, it was possible by means of negotiation to set out an agreed process for the implementation of such a scheme. The relief set out hereunder is aimed at giving effect to the implementation of more flexible investment choices within DENRET.

Relief - a negotiated solution

The complainant's complaints 2 and 3 are determined by agreement between the relevant parties on the following basis:

1. The Board of Trustees of DENRET shall in terms of rule 8.2(3) give effect to the request of the employer (Denel (Pty) Ltd) to make a special transfer of 40% of the balance in the employer's protection reserve in the reserve account in rule 2.2(3) pro rata to the share accounts of all members and pensioners who were members of the fund on 1 September 1994 and who on 30 August 1994 were also members of the Denel Pension Fund (DENPEN). Such transfers shall be effected on or before 30 November 1998. Former members of the fund who qualify for a pro rata share of the reserve but who no longer have a share account shall be paid their pro rata share in accordance with any appropriate instructions by the actuary of the fund.

2. The remaining 60% of the employer protection reserve shall be available to the employer to be applied with effect from 1 November 1998 until the reserve is exhausted to fulfil its obligations in terms of rule 8.2(1) to contribute to the member's share accounts in respect of each member of the fund at the rate of 12.8% of the member's pensionable emoluments, subject to the deductions for the cost of benefits and expenses contemplated in rules 5; 6 and 10.14 of the rules.
3. Any dispute concerning the computation of any amount to be distributed in terms of this determination shall be referred to an actuary appointed by the Adjudicator on such terms and conditions as the Adjudicator may determine. The decision of the actuary shall be final and binding on all parties.
4. The sub-committee appointed on 3 September 1998 by the Divisional Pension Committee (DIVCOM) of DENRET to further investigate free investment options is directed to proceed as follows:
 - 4.1 The sub-committee shall appoint an external, independent expert as project leader (on a part-time basis) on the recommendation of the members, subject to the approval of the trustees, to oversee the process of a needs analysis and to investigate the feasibility of introducing free investment options to members, after which his contract shall terminate.
 - 4.2 The remuneration of the project leader shall be for the account of DENRET, subject to the approval of the trustees.
 - 4.3 The project leader shall not receive any financial reward, advantage or benefit of whatsoever nature, other than the remuneration in clause 4.2 above, in respect of any services rendered to any person arising out of or in relation to any transaction connected with the introduction and management of the free investment options at DENRET.

- 4.4 The project leader shall be appointed on or before 31 October 1998.
 - 4.5 The project leader shall be granted an adequate budget (as approved by the Trustees) to enable him or her to consult experts for advice and guidance in implementing free investment options.
 - 4.6 The project leader and the sub-committee shall endeavour to complete a needs analysis on or before 30 November 1998 and shall act expeditiously in investigating the feasibility of introducing free investment options.
 - 4.7 The project leader shall report to the Board of Trustees and the members of DENRET and shall make appropriate recommendations for the introduction of free investment options, on or before 7 December 1998.
5. This determination is in full and final settlement of the complainant's second and third complaints lodged with the Adjudicator under cover of his attorney's letter of 29 August 1997.
 6. It is recorded that the complainant's first complaint and the complaint of the members of the "Denel Aftree Regsfonds" lodged with the Adjudicator on 29 August 1997 have been withdrawn.
 7. This determination is conditional on its approval and ratification by DIVCOM, the Denel Aftree Regsfonds and the Trustees of DENRET on or before 9 October 1998. In the event that DIVCOM, the Denel Aftree Regsfonds or the Trustees fail to approve and ratify this determination by the said date, or by a later date determined by the Adjudicator on application by one of the aforesaid parties, the determination shall lapse and the complaints of the complainant shall be adjudicated by the Adjudicator at a hearing to be held on 20 November 1998 in Pretoria.

DATED AT CAPE TOWN THIS 18TH DAY OF SEPTEMBER 1998.

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John Murphy
PENSION FUNDS ADJUDICATOR