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DETERMINATION IN TERMS OF SECTION 30M OF THE PENSION FUNDS ACT OF 1956 – N DEENADAYALU v LIFESTYLE RETIREMENT ANNUITY FUND & LIBERTY LIFE

[1] Having considered the complaint received by this office on 1 June 2005, I consider it unnecessary to hold a hearing in this matter. My determination and reasons therefor appear below.

The facts

[2] You became a member of the Lifestyle Retirement Annuity Fund with effect from 1 November 2002. Your initial contribution was R1250 per month subject to a 10% increase per annum. With effect from 1 April 2004 at which time your monthly contribution was R1925, you decided to reduce the contribution to R825 per month.

[3] You state that on reducing your contributions your fund value was reduced from R46 500 as at 26 February 2005 to R35 544.16 as at 30 April 2005. This is a reduction of R10 955.84. When you queried this with Liberty Life, you were advised that on reducing your contributions, a portion of the fees which would have been recovered over the life of the policy could no longer be recouped. Liberty Life therefore deducted these fees as a lump sum from your contributions in the investment account.

The complaint

[4] Your complaint is that the policy document only provides for a monthly fee equal to a percentage of the premiums paid. In other words the fee which Liberty Life is entitled to charge is dependant solely on the premium paid. However the lump sum deducted by Liberty when you reduced your contributions was unrelated to the premiums paid. On this basis you

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request reimbursement thereof.

The responses

The fund

- [5] In its response the fund states that on the inception of membership, the underwriter incurs various expenses relating to the policy issued to the fund. In the normal course of events, these expenses are recovered by means of small deductions from the contributions over the term of the policy. When a member ceases contributions prematurely, these expenses can no longer be recovered piecemeal. Therefore a lump sum is deducted from the investment account to recoup the part of the expenses which would otherwise not be recovered from the reduced contribution.
- [6] You reduced contributions by 57% and therefore 57% of the built-in expenses, an amount of R13 488.28, were, according to the fund, recoverable from your investment account.
- [7] The fund explains further that in so far as the policy contract does not allow for a reduction in contributions, in the event that a member reduces contributions, the relationship is no longer governed by the policy contract but by the rules established by the actuary for changes in contribution levels.

The insurer

- [8] According to Liberty Life, by reducing your contributions, you effected a novation of the policy contract. Your original policy was deemed to have been made paid-up and thereafter continued on the basis of the 'novated' policy in terms of which a reduced contribution was payable. Liberty Life says this entitled it to recover unrecouped expenses pertaining to the old policy. Liberty Life has provided the following table of the expenses which had to be recovered.

"Expenses and commissions incurred:

Commission	R11 091.64
Distribution, marketing costs and VAT, if applicable	R4 713.95
Acquisition costs	R2000.00
Ongoing renewal costs	R725.00
Finance charges on outstanding (expenses less recoveries)	R3 871.38
Total accumulated commissions and expenses	R22 402.38

Less Total recoveries:

Commission clawed back	R2 058.37
Marketing and distribution expense recovery	R680.59
Outstanding expenses at 1 December 2004	R19 663.43

- [9] Since your contributions were reduced by 57%, 57% of the outstanding expenses of R19663.43 equal to R11208.16 were deducted as a lump sum. (Liberty Life states that the figure of R13 488.28 provided by the fund in this regard is incorrect).

Combined response of fund and insurer

- [10] In a document titled "Overview and background to the contractual and other relationships between Liberty Life, the Lifestyle Retirement Annuity Fund ("the fund") and the members of the fund", both the fund and Liberty Life (hereinafter referred to as "the respondents") make further submissions in relation to your complaint.

- [11] The respondents raise a technical point that since your complaint concerns the operation of the underlying policy of insurance, I have no jurisdiction to determine your complaint. They state further that since the sole assets of the fund are its claims against the insurer, the fund would not be able to comply with an order directing it to reimburse the unrecouped expenses that were deducted.

- [12] On the merits, the respondents state that the unrecouped expenses are determined in accordance with section 52(3) of the Long-Term Insurance Act which requires the statutory actuary to set rules and methods for valuing policies when premiums are not paid. The following expenses, they say, are generally incurred in relation to the underlying policy:

- 12.1 commission payable to the intermediary;
- 12.2 marketing and distribution expenses (these typically cover items such as remuneration of sales managers, broker consultants, marketing aids, intermediary training and compliance costs)
- 12.3 acquisition expenses (these expenses include the cost of issuing the policy document/s and loading the policy onto the computer system)
- 12.4 renewal expenses (these include costs of maintaining the computer systems, responding to queries, communicating with policyholders, and complying with statutory reporting)

- [13] The respondents state that it is important to differentiate between the insurer's expenses on the one hand and charges on the other. A large proportion of the expenses are incurred at the inception of the underlying policy. The charges on the other hand are the means by which these expenses are recovered over the term of the policy. The 'premium

reduction charge' enables the insurer to recover the expenses it has already incurred but which it can no longer recover by way of a normal charge.

Determination and reasons therefor

[14] The Lifestyle Retirement Annuity Fund is a pension fund as defined in the Pension Funds Act, 24 of 1956. The provisions of that Act, including chapter VA (which confers jurisdiction on the Adjudicator to investigate and determine complaints against pension funds) therefore apply to it. That its assets consist wholly of insurance policies does not alter the position. Therefore Liberty Life's argument that the matter concerns the "operation of a life policy" which excludes my jurisdiction cannot be sustained. (See *Du Plessis v Lifestyle Retirement Annuity Fund & Another* [2005] 5 BPLR 383 (PFA); *Gagiano v Lifestyle Retirement Annuity Fund & Another* [2005] 6 BPLR 474 (PFA); *Geldenhuys v Lifestyle Retirement Annuity Fund and Another* [2005] 5 BPLR 394 (PFA) and the authorities referred to therein).

[15] Furthermore, Davis J (in whose judgment Le Grange AJ concurred) in the as yet unreported decision in *Central Retirement Annuity Fund v Adjudicator of Pension Funds, FE de Beer & Another*, Cape Of Good Hope Provincial Division Case No. 3404/05 (handed down on 20 October 2005) ("the de Beer judgment"), at page 9, confirmed the jurisdiction of this office and stated:

"The basis of the complaint was that applicant [Central Retirement Annuity Fund] as the holder of the policy on the life of a member, was neither obliged nor entitled simply to allow Sanlam Life [the insurer] to charge whatever costs and charges it chose to levy and to accept whatever investment bonuses that it chose to declare from time to time without first satisfying itself through its own management committee of the reasonableness or adequacy thereof.

The Rules of the Fund set out its essential purpose as being to provide benefits to members upon retirement. The fact that applicant may be exempt in terms of the applicable law from audit cannot exempt it from playing a role in the fulfillment of its purpose. In any event, applicant is a pension fund organization and has separate legal personality in terms of s51(a) [sic] of the Act. It cannot simply be treated as an illusionary 'go between' the members such as second respondent and Sanlam Life. It should be accountable to its members and hence be subject to the discipline of the Act's complaint mechanism."

[16] As the Supreme Court of Appeal stated in *Tek Corporation Provident Fund and others v Lorentz* [2000] 3 BPLR 227 (SCA) at paragraph [28], the trustees may only do with the fund's assets what is set forth in the rules. If what they propose to do is not within the powers conferred on them by the rules, they may not do it. That the rules of a fund are king is confirmed by section 13 of the Act.

[17] The respondents refer to rule 5.2 which reads:

“If a MEMBER prematurely discontinues his CONTRIBUTIONS to the Fund, then provided CONTRIBUTIONS have been paid for the minimum period required in terms of the assurance on the MEMBER’S life he will be entitled to paid-up BENEFITS under the Fund for an amount determined in relation to the actual CONTRIBUTIONS paid.”

[18] Rule 5.2 governs the situation where a member discontinues contributions altogether and the underlying policy is then made paid-up. You did not cease contributions to the fund. You simply reduced your contribution rate. Furthermore your underlying policy was never made paid-up. Therefore rule 5.2 has no application. In any event I fail to see how rule 5.2 authorises the deduction of a premium reduction fee on cessation of contributions.

[19] The respondents state that rule 5.2 must be read with the relevant provisions of the underlying policy. However they fail to specify those provisions. On my own perusal of the policy document, I could find only one section which appears to be relevant. It appears under the heading “Important Notes” and reads:

“In the case of a withdrawal of funds before the contractual option date, or in the case of early retirement, surrender or early retirement charges may apply ...”

[20] It is not clear what constitutes ‘a withdrawal of funds’. However even if I were to assume in favour of the respondents that it governs the position where a member reduces his contribution rate, the section is still too vague to assist their case. For example there is nothing to indicate how the surrender charges are calculated and their composition. The section certainly cannot be relied upon as authority to accelerate part of the expenses incurred at the inception of the underlying policy and to deduct them as a fee from your contributions in the investment account.

[21] The respondents themselves concede that the levying of a ‘premium reduction charge’ is not specifically authorized in the policy documents. They state as follows:

“Over and above these regular charges specifically itemized in the policy documents, a further charge, usually referred to as a “premium cessation charge” or “premium reduction charge”, is levied on the premature cessation of contributions, to enable the Insurer to recover the expenses it has already incurred but which can no longer be recovered by way of the normal charges.”

[22] As you correctly point out, the only charges authorized by the policy document are the ongoing monthly charges which are expressed, in the main, as a percentage of the monthly contribution.

[23] For these reasons, you are entitled to reimbursement of the premium

reduction charge that was deducted.

Relief

[24] In the result I make the following order:

- 24.1 The Lifestyle Retirement Annuity Fund and Liberty Life are jointly and severally (the one paying the other to be absolved) ordered forthwith to credit the complainant's investment account in the fund with the amount of R11 208.16 that was deducted.
- 24.2 The Lifestyle Retirement Annuity Fund and Liberty Life are further jointly and severally (the one paying the other to be absolved) to credit the complainant's investment account in the fund with interest on R11 208.16 at the rate of 15,5% per annum from the date of this determination until the date of final crediting.

DATED AT CAPE TOWN ON THIS THE DAY OF 2005.

Yours faithfully

VUYANI NGALWANA
PENSION FUNDS ADJUDICATOR

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Section 30M filing: Magistrate's Court