Final

IN THE TRIBUNAL OF THE PENSION FUNDS ADJUDICATOR

(HELD IN JOHANNESBURG)

CASE NO: PFA/KZN/2803/05/CN

In the complaint between:

Brent G Walters **Complainant**

and

MM Retirement Annuity Fund **First Respondent**

Momentum Group Limited **Second Respondent**

DETERMINATION IN TERMS OF SECTION 30M OF THE PENSION FUNDS ACT, 24 OF 1956 ("the Act")

Introduction

[1] This complaint concerns the value of the complainant's investment in the respondent retirement annuity fund after he ceased making contributions thereto. It raises an issue where, for the first time, the insurer in effect admits to rendering banking services to members of a retirement annuity fund by

granting unsolicited loans for purposes of repayment of commissions paid by the insurer in advance (in the first two years of membership of the fund) as remuneration to brokers who managed to prevail upon the member to join the retirement annuity fund administered by that insurer. This practice appears to be widespread among retirement annuity funds administered by life insurance companies that pay commissions in advance and capitalise other future costs.

[2] This is how it works. A broker approaches Jane Soap with a view to selling her a policy. The broker recommends that she joins a retirement annuity fund because of the income tax advantages of doing so. Jane does. She is 25 years old and chooses a retirement age of 55, meaning she undertakes to make contributions for the next 30 years in order to save for retirement. The fund invests her contributions (together with those of other members of the same fund) in an insurance policy or unit trust portfolio sold by ABC Life Insurance company. ABC's actuaries work out what the total value of Jane's investment will be in 30 years' time and pay out a percentage of that estimated value (agreed with the broker) to the broker in two instalments – the first in year one and the second in year two of Jane's membership. At the same time, ABC opens a loan account for Jane without seeking her permission first, without

explaining to her the implications thereof and without giving her the option of either paying the commission as an when it arises on a monthly basis, or in a lump sum from her own private funds. ABC charges interest of 10 to 12% a year on the balance of the loan and this is deducted monthly from Jane's contributions. ABC will, of course, say there is no deduction from Jane's monthly contributions because the loan amount is recouped by cancelling units in Jane's investment. But those units are purchased by Jane's monthly contributions and so such a submission is really six of the one and half-a-dozen of the other. When Jane hits hard times and stops making contributions after just two years of membership, ABC digs into Jane's nest and take the entire amount that is outstanding on the loan that Jane never sought. If the balance of the loan is more than the contents of Jane's nest, tough for her. She gets nothing. Because she never asked for a loan and she remains a member of the fund until 55, Jane finds it a little puzzling that two years' savings should wither away not in market volatility but in "costs". Understandably, she sees no reason to keep ploughing more of her money into such a fund and so she stops. This, in broad terms, is the practice that is causing so much unhappiness among members of these life company retirement annuity funds. All this happens in full glare of the trustees' trammelled vision. How this can be in the

best interest of members (which must, under section 7C(2)(a) of the Act, inform trustees' actions) is hard to imagine.

The facts

[3] The complainant became a member of the MM Retirement Annuity Fund ("the fund"), a fund registered in terms of the Act as a pension fund organisation, on 1 July 2002. The fund is administered and underwritten by the Momentum Group Limited ("Momentum"), which is a registered life insurance company.

[4] During 2002 the complainant, who owns a construction company, joined the fund and started making recurring contributions of R1000 per month, with effect from 1 July 2002. As is provided for by the rules of the fund, he selected a retirement date of 1 July 2020. In other words, his membership was to endure for 18 years.

[5] Because of cash flow problems in his business and a need to ensure that his staff did not lose their jobs, the complainant decided to "cut back on certain

items". On 6 September 2004, aged 40, he approached Momentum and advised that he was thenceforth ceasing to make contributions. He says at that stage he had already made contributions amounting to R24 000 over a two-year period.

[6] He was informed that the value of his investment at that stage was R12 623-51 from which outstanding commission of R9 545-87 would be deducted leaving, in his own words, "a pathetic amount of R3 166-00 which they also said [he] [could] not have". According to Momentum the costs that were charged were an "alteration fee" (R250), a "policy fee" (R240), "premium charges" (R1 050-85), a "portfolio fee" (R140-40) and an amount towards the "amortisation of commission loan account" (R10 554-19), all amounting to R12 235-44. According to the fund as at 9 May 2005 the fund value of the investment was R13 750-00.

<u>The complaint</u>

[7] The complainant says he finds it "unacceptable" that Momentum can "take all

the monies that [he had] paid in" when he was forced by matters beyond his control to cease making contributions to the fund.

The response

[8] In a joint response Momentum and the fund state that the former was entitled by the provisions of the "Key Features Document" and the rules of the fund to deduct the amount of R12 235-44. They further state that they cannot pay out the complainant's contributions as that would amount to a withdrawal from the fund, which in terms of the rules may only take place when a member is between the ages of 55 and 70.

[9] In response to a written request from my Assistant to refer this tribunal to the relevant rules that authorize the insurer to make deductions from a member's investment, the fund stated that:

[9.1] Section 2, which defines the "pension interest", makes the interest subject to the funds available in the "Fund Member Policy", and that

Fund Member Policy sets out the deductions that will apply;

[9.2.] Rule 4.4 of Section 4 states that a member is bound by the terms of the Fund Member Policy, which thus reinforces the deductions that have been disclosed in the Fund Member Policy;

[9.3] Rule 5.2 of section 5 entitles a member who ceases to make contributions to "paid-up benefits".

Determination and reasons therefor

[10] The fund being a registered fund in terms of the provisions of the Act is bound by its rules in the same way as its members, officials, shareholders and persons claiming under the rules. That much is evident from section 13 of the Act. Thus, the trustees of the fund (and any service provider such as the administrator of the fund) may only do with its assets what is set forth in the rules. Thus whatever costs that may be deducted from a member's investment must be provided for in the rules and/or explicitly disclosed in the fund

member policy.

[11] There is no definition of "pension interest" in the definition section (section 2) of the rules, but rather a definition of "fund member policy" which in my view does not take the matter at issue any further. "Fund Member Policy" is defined as an insurance policy taken out by the fund to cover its obligations to the member.

[12] Rule 5.2 provides as follows:

> "If a MEMBER prematurely discontinues his CONTRIBUTIONS to the FUND, then provided CONTRIBUTIONS have been paid for the minimum period determined by the ACTUARY he will be entitled to paid-up BENEFITS under the FUND as determined by the ACTUARY."

[13] The rule merely provides for the payment of "paid-up benefits" to a member who has prematurely discontinued contributions after having paid contributions for the minimum period. There is no definition of "paid-up BENEFITS", and certainly no provision for the charging of fees against a member's investment account in the event of his stopping contributions before

his chosen retirement date. In any event, whatever the meaning of "paid-up BENEFITS" may be, it does not apply in this case because it only comes into play when "*benefits*" become payable. A "benefit" is defined as "any annuity or any sum of money or any right or asset measurable or sounding as a sum of money, payable or transferable to a MEMBER or to any person arising out of a MEMBER'S MEMBERSHIP of the FUND". The rules provide for the payment of benefits only on retirement, ill-health and death. None of these events have occurred in this case. Thus, because no "benefits" are payable to the complainant yet (be they "paid-up" or not) rule 5.2 does not advance the respondents' case for the charging of the fees in dispute.

[14] Rule 4.4 in section 4 of the rules is in my respectful view an entangled mess that does not even remotely say what appears to have been intended. The rule says the rules of the fund are binding on a member or any person "claiming any BENEFITS arising out of [his] MEMBERSHIP of the FUND". Why the binding effect of the rules should be limited to instances where the member claims a benefit is not clear. On a strict interpretation, this means the rules are of no application to the complainant because he is not claiming any benefit but questions the charging of certain fees. That, of course, would lead absurd

results. Rules are binding whether one claims a benefit or not.

[15] But what about the provisions of the "Fund Member Policy" on which the respondents rely? These comprise annexure "A" to the respondents' response ("the quotation document") and annexure "B" ("the key features document"). Rule 4.4, on a strict interpretation, says these documents are binding on the member only where they have been signed by the member. Those furnished by the respondents to this tribunal do not bear any signature of the complainant. But that is not the route I shall take because, even if it is accepted that these documents are binding on the complainant, they do not authorize the respondents to deduct the fees in dispute either.

[16] I shall deal individually with the fees and charges that have been debited to the complainant's investment account and explore whether each is sanctioned by these documents.

[17] The **"policy fee"** of R10 per recurring contribution is provided for in the quotation document. As the complainant had made recurring contributions of R24 000, the amount of R240-00 was correctly charged.

[18] The **"premium charges"** of R40-42 are provided for in the quotation document. The explanation is that it is meant "to cover the ongoing expenses associated with the investment and is deducted each time a contribution is due". But 24 monthly contributions at a premium charge of R40-42 each result in R970-08, not R1050-85. The R80-77 difference is unexplained.

[19] There is no reference to a **"portfolio fee"** either in the rules, on the one hand, or in the quotation document or the key features document, on the other. One is left to assume that this is represented by "asset management fees" and/or "fund administration fees" because provision for these is contained on page 2 of the quotation document to which the respondents point for charging a "portfolio fee". But the quotation document says "asset management fees" are to be "taken into account in the calculation of the unit prices, ***therefore, there will be no actual deduction from the investment fund***" (my emphasis). This is reiterated in the key features document. Similarly, both the quotation document and the key features document say fund administration fees are charged "by cancelling units in the relevant investment funds on a monthly basis". Nowhere is there provision for the deduction thereof in the event of the member ceasing

to make contributions.

[20] The relevant portion of the key features document on which the respondents rely as authority for charging an **"alteration fee"** reads as follows:

> "Charges when you make changes to the investment: we may charge an administration fee for certain types of changes made to the investment, depending on the rules at the time. The level of these changes will be determined from time to time".

This clause suggests that the charging of an administration fee for certain types of changes made to the investment depends on what the rules provide for. I have not found any reference in the rules to an "alteration fee". Besides, the complainant did not "alter" or "change" the investment, but rather ceased making contributions.

[21] As regards the "**amortisation of commission loan account"**, the quotation document provides for the payment by Momentum to the member's financial advisor of a monthly commission of R540-00 for the first year and R180-00 for the second year. On page 7 of the key features document it is stated that an

"upfront sales fee" of R6 480 was paid to the complainant's financial advisor, and that the amount would be recouped by cancelling units in the relevant investment funds on a monthly basis. The amount cancelled each month is called the commission loan instalment. This amount appears to represent only the first year's commission because in their further response the respondents say that a further R2 160 was paid in commissions on 1 July 2003, totalling some R8 640-00 (excluding interest). With interest (the respondents say at a rate of 12% per annum) as at 6 September 2004 when the complainant stopped contributions, the commission bill had risen to R9 457-87. Some 11 months later (as at 9 August 2005) the bill had increased by over R1000 presumably in interest and was sitting at R10 554-19. This suggests that either the fund or Momentum or both are running a banking business with these unsolicited loans.

[22] But, because the complainant has stopped making contributions, do the respondents have a right to accelerate repayment of this unsolicited loan? The quotation document says the loan will be recouped "over the term of this contract" (namely, over a period of 18 years). The key features document says it will be recouped by a cancellation of units in the relevant investment funds

on a monthly basis but does not say over what period. There is no reason to believe that what is intended is a period that is different from that provided for in the quotation document.

[23] There is no authority either in the rules or in the key features or quotation document for the acceleration of the payment of the loan in the event that the member ceases making contributions before the end of the 18-year term. As the complainant is still a member of the fund, there is no reason to believe that his financial position may not improve sufficiently within 18 years to enable him to resume his contributions so that more units may be gradually cancelled to pay off the loan gradually. That is what the binding documents provide for. If the respondents desired to recoup these amounts in one lump sum upon cessation of contributions (albeit not knowing whether and, if so, when they will resume) they should have said so in the rules or in the quotation and/or key features documents.

[24] Momentum says the projected total commission loan amount that would be recouped at the end of the 18 year period is R22 820 – and this on an unsolicited loan of R8 640 some 18 years previously. “This means”, says

Momentum's Mr Kruger unperturbed, "that the total interest that would have been added until 1 April 2020 [some three months before the complainant's retirement date at age 55] would [be] R14 180". Evidently, he sees nothing wrong with this mortgage bond-type arrangement. This, in my view, is an undesirable business practice where a life insurance company retained by a retirement fund to administer its business creates for itself a profit centre by rendering what is in effect an unsolicited banking service. This practice is widespread among retirement annuity funds administered by life companies and which pay commissions in advance. For that reason, a copy of this determination will be forwarded to the Registrar of Pension Funds, the Registrar of Long-Term Insurance and the National Treasury for consideration.

[25] Although not relied upon by the respondents, the key features document, under the heading "What are the rules about the contributions?" says (at page 10 under sub-heading 'Cancelling future contributions'):

> "An administration fee may be charged for cancelling the contributions. The investment values may also be reduced to allow for any costs on the contract that we have not yet recovered."

[26] This provision is couched in such vague, imprecise and general terms that one cannot reasonably discern therefrom what is included within the elastic ambit of "*any costs ... that we have not yet recovered*". The phrase is couched in such wide terms that it can be interpreted to include costs on the contract the recovery of which is not provided for in either the contract itself or the rules.

[27] A language of similar sort appeared in a contract between the parties in the case of *Speigel v Eilenberg* (1903) 20 SC 247 at 251, where the following words were used:

> "If you care to come to Africa, I am prepared to find you employment as a traveller in town or any such work as you may be suited for".

[28] The court held that this kind of language is so vague and indefinite as to be incapable of enforcement. The language quoted in paragraph [25] above is no different from this. It is not clear why Momentum did not provide expressly for the reduction of investment values to allow for the recovery of the "upfront sales fee" of a specific amount (see page 7 of the key features document where commission is termed "up-front sales fee of R6,480.00") because that would

have removed any uncertainty of what the phrase "any costs on the contract" includes. The only reasonable conclusion to which one may come in the circumstances is that this open-ended license to "recover" costs was intended to facilitate the deduction of amounts far in excess of the capital amount of the original loan, as evidenced by the facts of this case.

[29] In the result, the clause cannot be legally enforced, in my view.

[30] In any event, the commission recoupment clause authorizes the recovery over the term of the contract of un-recouped costs. It is important to bear in mind that when the contributions ceased, the complainant remained a member of the fund and is still a member. Therefore, all costs to be deducted over the term of the contract as set out in the key features document can still be deducted on a monthly basis. There is nothing in the clause which permits the insurer to capitalize the future costs and deduct them in a single lump sum from the member's account upon the cessation of contributions.

Relief

[31] From the total amount of R12 235-44 that was charged in respect of costs, the insurer was only entitled to charge R1 290-85 (in respect of the "policy fee" and the "premium charge"). To the extent that the complainant seeks a refund of his contributions, this cannot legally be done because no withdrawal benefit is allowed from retirement annuity funds.

[32] The final order of this tribunal is therefore the following:

> The MM Retirement Annuity Fund and Momentum Group Limited are jointly and severally ordered forthwith to credit the complainant's investment account in the fund with the amount of R10 944-59, together with interest thereon calculated at 15.5% per annum, from the date of this ruling to the date of such crediting.

DATED AT JOHANNESBURG ON THIS DAY OF OCTOBER 2005.

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VUYANI NGALWANA

PENSION FUNDS ADJUDICATOR

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SECTION 30M FILING: MAGISTRATES' COURT