

Final

**IN THE TRIBUNAL OF THE PENSION FUNDS ADJUDICATOR
(HELD IN JOHANNESBURG)**

CASE NO: PFA/WE/2916/05/CN

In the complaint between:

Henriette Geldenhuys

Complainant

and

Lifestyle Retirement Annuity Fund

First Respondent

The Liberty Group Limited t/a Liberty Personal Benefits

Second Respondent

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

Introduction

[1] The issue that arises in this complaint – namely, the levying of lump sum charges or fees on a member of a retirement annuity fund by the life insurance company

that administers the business of that fund (with the surprising collusion of the trustees) upon the cessation or reduction of contributions by the member in circumstances where the rules make no provision for the levying of lump sum charges in that manner – is widespread among those retirement annuity funds administered by life insurance companies. The extent of this problem is demonstrated by the marked increase in the number of complaints to this tribunal on this issue in the recent past.

[2] Since March 2004 when the present adjudicator was appointed, the average number of complaints of all types, including death benefit apportionments, disability complaints, withdrawal and retirement benefit calculations, section 14 transfers, constitutionality of rule provisions and trustee decisions, rule amendments, and so on, was about 213 per month. Since 1 March 2005 this tribunal has received 1 116 complaints. Of these about 300 raise the issue of penalties charged by life insurance companies upon reduction or cessation of contributions to retirement annuity funds. This number excludes telephonic and walk-in enquiries and complaints in respect of which this tribunal is awaiting formal complaints as defined. It also does not include those complaints lodged with the Office of the Long-Term Insurance Ombudsman to whom the life insurance companies tend on occasion to refer such complaints.

[3] It is thus clear to me that this practice by life insurance companies of levying charges against members of retirement annuity funds administered by them upon

cessation or reduction of contributions where the rules make no provision for such levying of charges is endemic and requires urgent attention. Life insurance companies and their “union”, the Life Offices Association, have acknowledged that this is a problem although they seem to find fault only with advance payment of commissions to intermediaries covering the full period of the contract. In this case, for example, the full commission, calculated on the full value of the contract as at the complainant’s selected retirement age of 60 (1 April 2027), is paid in the first two years of a 24 year contract.

- [4] In my view, the “upfront” payment of commissions is only part of the problem. The main problem is that the deduction of these fees in the manner currently done by life insurance companies and retirement annuity funds is nowhere provided for in the rules. The solution is simple. Amend the rules to provide for deduction of these “penalties” in the event of contribution reductions or cessation. That done, these complaints should disappear and the trust in life insurance companies restored.

The Facts

- [5] The complainant is a 38-year old woman. Her parents had quietly been saving money for her over a 20 year period. In 2003 they presented her with the R10 000 cheque that was the fruits of a 20 year diligent saving for their daughter. She says she decided not to spend it but, “as a way of honouring [her] parents for saving

money for [her] over such a long period of time”, to save it so that it can continue to grow.

[6] To that end she approached her bank, First National Bank, with the R10 000 cheque who referred her to an in-house financial advisor. The financial advisor suggested that she invest the money in the Liberty Life Lifestyle Retirement Annuity Fund (“the fund”). On 3 April 2003 she made the first contribution of R10 000 into the fund seemingly as an annual contribution. Around April 2004 she found annual contributions (which were to escalate automatically by 10% every year) unmanageable and did not pay the R11 000 annual contribution due in April 2004. She then approached her financial advisor with a view to reducing contributions from an annual contribution of R11 000 for the 2004 year to monthly contributions of R550. This arrangement was ultimately agreed to by the fund and Liberty Life and she commenced by paying R1 650 in June 2004 (comprising R550 each for the months of April, May and June 2004). That was soon followed by further monthly contributions of R550 each for the months of July to November 2004. In total, she has contributed R14 400 into the fund.

[7] When she took up full-time employment and had to join her employer’s pension fund as an employment condition and pay monthly contributions of R1 200 into the employer’s pension fund, she says she could no longer sustain contributions to both the fund and the employer’s fund. In November 2004 she requested her financial advisor to “close the Liberty Life policy”. To her utter dismay, Liberty Life

informed her in a document dated 29 November 2004 that her “total investment value as at 29/11/2004” was R5 945,08. She now wants the R8 455 (R11 907,06 according to the fund as will become clear later) that has been deducted from her contributions as well as the R5 945 that is said to be the value of her investment.

The Complaint

[8] The complainant says there is nothing in the “policy documents” that indicates what kind of penalties she would be subjected to if she stopped making contributions. She says she never gave Liberty Life permission to take R8 455 (R11 907,06 according to the fund) of her money. She says she “saved the money with the intention of keeping it, not losing it”. She also wants to “sever all ties with Liberty Life” which she says “was prepared to take a large chunk of my money without any warning or any concern for me”. In the result, she seeks the return of the R8 455 taken from her and the R5 945 that is said to be her total investment value.

The Response

[9] In response to the complaint, the fund has raised two technical points, the first being an allegation that this is not a complaint as defined because it relates to the operation of a life policy concluded between the fund, on the one hand, and Liberty

Life as insurer, on the other, relating to the provision of benefits in respect of the member.

[10] The second point is that as the fund has no assets other than claims against the insurer arising out of policies of insurance, in order for an order of this tribunal to be effective the adjudicator would have to make an order against the insurer which falls outside his jurisdiction. It also maintains that there is no contractual nexus between the insurer and the member.

[11] On the merits, the fund argues that rule 5.2 entitles it, in the event of a discontinuance of contributions prior to the retirement date, to pay a member, at retirement, paid-up benefits comprising an amount determined in relation to the actual contributions paid. It further submits that the contractual provisions of the policy authorize the insurer to levy charges, over the term of the policy, against the investments made by policyholders so as to recover the expenses incurred by the insurer, which include commissions paid to intermediaries, marketing and distribution expenses, acquisition expenses and renewal expenses. It says the actual charge deducted is R11 907,06. It then seeks that this complaint be dismissed.

Determination and Reasons therefor

[12] In this case, the complainant has been penalized both for reducing her contributions from R10 000 per year to R550 per month (in respect of which she has been charged R2 666,08) and for stopping contributions (in respect of which she has been charged R9 240,98). Thus, the simple issue that calls for determination is whether the fund and Liberty Life are entitled to deduct an amount from the complainant's contributions by reason solely of her first reducing and then stopping contributions to the fund. The answer must lie in the rules of the fund, the Pension Funds Act and the Income Tax Act. None of these entitle Liberty Life and the fund to do this. Even the policy documents (which can be of no application to the complainant if the fund's argument is correct that they embody a "contractual nexus" between the fund and Liberty Life) do not.

[13] But before dealing with the merits of the complaint, it is necessary to dispose of the fund's technical defences.

Is it a complaint as defined?

[14] A complaint is defined in section 1 of the Act as follows:

"complaint" means a complaint of a complainant relating to the administration of a

fund, the investment of its funds or the interpretation and application of its rules, and alleging-

- (a) that a decision of the fund or any person purportedly taken in terms of the rules was in excess of the powers of that fund or person, or an improper exercise of its powers;
- (b) that the complainant has sustained or may sustain prejudice in consequence of the maladministration of the fund by the fund or any person, whether by act or omission;
- (c) that a dispute of fact or law has arisen in relation to a fund between the fund or any person and the complainant; or
- (d) that an employer who participates in a fund has not fulfilled its duties in terms of the rules of the fund;

but shall not include a complaint which does not relate to a specific complainant;”

[15] There is no dispute that Liberty Life is the administrator of the fund. In fact the fund expressly says so at page 2 of its response (*“Liberty Life fulfils the role of Administrator of the Fund”*) and Liberty has not denied the allegation. Inasmuch as the complainant contests the deduction of R8 455 (R11 907,06 according to the fund) from her contributions by the administrator of the fund, there can be no *bona fide* dispute that this complaint relates to the administration of the fund by Liberty Life.

[16] There is also no dispute that the complainant's complaint relates to the investment of retirement funds by the administrator. The complainant says:

"I was shocked to find out there's only R5 945 left in the policy, out of a total amount of R14 400 that I paid into the fund. The penalties amounted to R8 454. At first, I thought it was an honest mistake and asked Liberty Life to correct it. When I was informed that it was in fact true, I felt robbed.

It was hard to believe that it could be legal for a company to take a person's money like that. This is almost all the money my parents had saved. It took my parents two decades to get this money together and Liberty takes it in an instant!"

[17] It is thus clear that the complaint relates to the investment of funds and that the complainant alleges that she has "sustained ... prejudice in consequence of the maladministration of the fund by ... any person", and that person is clearly Liberty Life, the administrator. In *Armaments Development and Production Corporation of SA Ltd v Murphy NO and Others [1999] 11 BPLR 227 (C) at 231C* the Cape High Court put the issue thus:

"Sub-paragraph (b) of the definition [of complaint] makes this distinction even clearer by referring to prejudice suffered by a Complainant as a result of the maladministration of the fund by the fund *or any person*. Clearly this has to be a person administering the fund or performing any of the functions prescribed in the Act or rules for such person"

(italics in original text)

[18] Thus, if Liberty Life is the administrator of the fund and it has deducted R11 907,06 from the complainant's contributions of R14 400 in circumstances where no provision is made for such deduction anywhere in the rules of the fund (or in any other document) in strict accordance with which the business of the fund must be administered, and the complainant cries foul, such a scenario clearly falls within the compass of a complaint as defined.

[19] The fund's submission that this is not a complaint as defined thus falls to be dismissed.

Does the adjudicator have jurisdiction?

[20] The fund says the adjudicator has no jurisdiction to investigate this matter because "it relates to the operation of a life policy concluded between the Fund and Liberty Life" (the "contractual nexus" argument). This is not correct as demonstrated by the examples hereunder. But before setting out those examples I must point out that Liberty Life expressly maintains in a relevant document filed in response to the complaint that this tribunal does have jurisdiction to hear this matter although it still gives out an old address that was used at the infancy stages of this tribunal in 1999. The document reads:

“If the matter is not resolved to your satisfaction within 30 days after we receive the letter, you will be able to address a written complaint to the Pension Funds Adjudicator, Prof John Murphy, at 36 Roeland Square, Drury Lane, Cape Town, 8000.”

While this is a clear demonstration that there is no merit in this afterthought argument that the adjudicator has no jurisdiction here, the information provided is nonetheless of concern for at least two reasons. For one thing, the person referred to as the adjudicator has not been such for more than two years now. For another, the incorrect information given to members can potentially deprive them of access to the free and expeditious service offered by this tribunal and, if it were not for the extensive and vigorous public awareness campaign embarked upon by this tribunal, be at a loss as regards where to complain.

[21] The following are just a few examples that demonstrate the folly of the fund’s “contractual nexus” argument.

[21.1] In a letter dated 5 April 2003 welcoming the complainant to Liberty, Liberty thanks the complainant for investing in Liberty Excelsior Investments. It does not thank the fund for doing so.

[21.2] In the same letter addressed to the complainant and under the heading

“Your new contract” Liberty Life says to the complainant, “This investment provides the flexibility of choosing your own investment options or the peace of mind of choosing portfolios that reflect your risk profile”. This is clearly directed to the complainant and not the fund.

[21.3] Liberty Life then gives the complainant a Liberty call-centre number and that of his own financial advisor in the event of any further information being required by him on his new contract.

[21.4] Elsewhere in the policy documentation under the heading **“Compliance and Complaints”**, Liberty says the following to the complainant:

Should you have any queries or complaints regarding your contract, please first contact your financial adviser and discuss the problem with him/her. If the matter is not handled to your satisfaction, you can contact the Liberty Policyholder Relations Department on telephone ... or fax ...” (my underlining)

[21.5] A document titled **“ADDITIONAL INFORMATION ABOUT YOUR RETIREMENT ANNUITY”** is also clearly by its terms addressed and directed to the complainant and not the fund, thereby disproving the fund’s “contractual nexus” theory. Clauses 11 and 12 thereof demonstrates a direct relationship not between the fund and Liberty but between the complainant and Liberty. They read:

- “11. Your purchase of this Retirement Annuity gives you membership of Liberty’s Lifestyle Retirement Annuity Fund ... The Rules of the Fund are available on request from Liberty...
12. If any dispute arises concerning your Retirement Annuity, you should put your concerns in writing, addressed to the Principal Officer, Personal Benefits Legal Services If the matter is not resolved to your satisfaction within 30 days after we receive the letter, you will be able to address a written complaint to the Pension Funds Adjudicator”

There is thus, on Liberty Life’s own documentation, no merit in the argument that there is no contractual nexus between the complainant, on the one hand, and Liberty Life on the other.

- [22] In simple terms, this matter concerns the administration of the fund by Liberty Life (at the trustees’ behest) as a result of which the complainant has suffered R11 907,06 worth of prejudice while the trustees inexplicably bat for the other side (namely, the insurer). That has nothing to do with the “operation of a life policy”.

The Merits

[23] The fund says, firstly, that when the complainant reduced her contribution by 34% from R10 000 per annum to R550-00 per month, it meant that 34% of the expenses costs could no longer be recouped, thus Liberty Life set off a “lump sum adjustment of R2 666-08 against the investment value”. Secondly, it says because the complainant did not make any further contributions to the fund after November 2004, “the benefit attributable to her by virtue of membership [became] paid-up with effect from 1 December 2004 for reduced benefits, in accordance with clause 7 of the policy.” It goes on to say when the complainant stopped making contributions, her total investment value was R15 149-16, and that “for the purpose of determining the asset value, Liberty Life deducted an amount of R9 240-98 from the total investment value.

[24] In response to a query from my Assistant, the fund explained that the amount in question was a percentage of the total actual costs incurred by the administrator in respect of the investment contract, which are tabulated elsewhere in the response as follows:

“The total amount of commission (including VAT) paid in respect of the policy amounted to R11 214-15. Mrs Geldenhuys paid contributions for 20 months. As a result, full vesting of the commission was not paid in respect of the initial contribution occurred (*sic*).

When the contribution was reduced from R10 000.00 per annum to R550.00

per month with effect from 01 April 2004, the expenses could now not be recouped by the reduced contribution. The contribution reduction of 34% meant that 34% of expenses could no longer be recouped. Hence the lump sum adjustment of R2 666-08 was set off against the investment value.

The investment value prior to adjustment was R14 728-71. After the adjustment the Investment Value was reduced to R12 062.44. The reduction of the investment value at 30 March 2004 was 18%. The actual costs and expenses incurred by Liberty Life in respect of this contract are as follows:

Commission plus VAT	R11 214-15
Distribution plus marketing costs	R 2 803-54
Initial administration plus acquisition expenses incurred at new business stage	R 2 000-00
Ongoing renewal costs	R 500-00
Finance costs on outstanding expenses less recoveries	R 2 531-90
Less commission claw back	R 653-66
Outstanding expenses as at 30/11/2004	R14 469-20

The actual charge deducted from the investment value at 30 November 2003 (*sic*) was R9 240-98 when the policy was made paid-up.”

[25] Thus, instead of deducting the total amount of outstanding expenses (R14 469-20) from the complainant’s investment value, Liberty deducted an amount of R9 240-98

in respect of the outstanding expenses, as well as R2 666-08 for reducing the premium. In total, therefore, an amount of R11 907-06 was deducted from the complainant's contributions.

[26] For this the fund relies on rule 5.2 which provides as follows:

"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."

[27] The rule only states that the "paid-up" amount is determined in relation to the actual contributions paid but does not explain how the amount will be determined. It certainly makes no provision for deduction of charges upon cessation of contributions.

[28] This rule must, however, be read together with a provision in the "Terms and Conditions" policy document which reads as follows:

"PAID-UP BENEFITS

Provided that the Contract has an Asset Value it may be paid-up. No further contributions shall then be payable, and all benefits otherwise payable shall be reduced accordingly. The reduced benefits shall continue to participate in the Portfolio/s selected."

[29] There is nothing in this clause that provides for deduction of charges in the event of a member discontinuing contributions to the fund. What it says is that benefits will be “reduced accordingly” without saying how this is to be done. Now, what the complaint seeks when she stopped contributions cannot legally be termed “benefits” worthy of reduction under this clause. A retirement annuity fund cannot pay “benefits” until the member has reached retirement age (at least 55), or the member has become disabled, or the member has died (in which event death benefits are paid to her dependants). None of these has occurred and so the complainant’s claim does not fall to be reduced under this clause.

[30] The fund relies also on clause 7 of the policy document. That clause provides:

“NON-FORFEITURE

If any Contribution is not paid within the days of grace and the Contract has acquired an Asset Value, the Contract shall be made paid-up for reduced benefits. No further contributions shall then be payable.

The Asset Value is the value of the Investment Account reduced by any applicable Non-Forfeiture charges and an amount in respect of any unrecouped expenses determined by Liberty’s Actuary.”

[31] Nowhere in the policy documents are the “applicable non-forfeiture charges” either defined or set out, nor is any explanation given regarding the method of, or the

basis for, calculating the “amount in respect of any unrecouped expenses determined by the Liberty’s Actuary”. The policy documents also do not set out the nature of the expenses falling within the ambit of “unrecouped expenses”. One is left to assume that they are those set out as follows in the documents:

“Actual contract benefits will depend on the actual contributions paid, the actual declared investment returns applied to the contract from time to time, as well as on the fees and charges deducted. Details of fees and charges are set out in this quotation and should be read carefully.

...

Charges and Fees	Contribution charge	Guarantee charge
Retirement Annuity		
Recurring Contribution	R345-80	R 0.00
Portfolio Management Fee:	0.16% p.m.	Allan Gray Balanced Cpi Plus
Policy Fee:	R 1200-00 p.a.	

...

- Commission payable to financial advisers is currently regulated by law. This amount is not deducted directly from your contributions, but is recovered from the contract charges set out above over the term of the contract.

- The standard Commission payable to an independent financial adviser for this contract is R600-00 per month in the first year and R200-00 per month in the second year. Commission may be paid annually in advance.
...
- The charges shown are those deducted by Liberty. An ongoing management fee may have already been deducted by the fund manager. This management fee is reflected in the unit prices of these funds. The level of these fees varies depending on the fund selected. Where applicable the bid offer spread is included in the unit price of these funds..." (My underlining)

[32] Since the charges that are detailed above are monthly charges and should thus have been deducted over the past nineteen months of the complainant's contribution, I cannot find any reason for their continued deduction for the notional remainder of the life of the contract. That goes also for the annual policy fee for which there can be no reasonable justification if a member has ceased contributions and has expressly indicated no intention of resuming same. Furthermore, the policy document expressly states that the commission payable to financial advisers "is not deducted directly from [the complainant's] contributions, but is recovered from the contract charges ... over the term of the contract". There is no provision for how this commission should be recouped in the event of the complainant stopping contributions before the contract has run its course. It is not open to Liberty Life or the fund simply to lump such commission together with the other charges and recover it from the complainant's contributions. Where there is no provision for a

particular scenario in the rules (or other related documents), it simply cannot be done. There is no room for being creative and opt for analogous scenarios. As the Supreme Court of Appeal has said in *Tek Corporation Provident Fund and Others v Lorentz* [2000] 3 BPLR 227 (SCA) at paragraph [28] in this regard, the trustees may only do with the fund's assets what is set forth in the rules. Thus, if what they propose to do is not within the powers conferred on them by the rules, they may not do it.

[33] In the result there is no basis for deduction of commission or any other expenses other than those detailed in the policy from the complainant's contributions.

[34] Section 13 of the Pension Funds Act provides that the rules of a fund are binding on the fund, its members, shareholders, beneficiaries and officers thereof. There is no provision in the Act for the deduction of "unrecouped" expenses from a member's contributions upon discontinuation of contributions to the fund.

[35] I should finally point what I consider to be an inevitable effect of what has been done in this case by the fund and its administrator on the fund's income tax status. One of the conditions for the approval of a retirement annuity fund for income tax purposes is that its rules must provide for either the payment of an annuity determined in relation to his actual contributions to a member who discontinues contributions prematurely, or for such member's reinstatement as a full member under conditions prescribed in the rules. Nothing in the Income Tax Act permits

such deduction from a member's contributions. Paragraph (c) of the definition of a retirement annuity fund in the Income Tax Act requires such a fund to comply with its rules in order for it to be approved for income tax purposes. As the rules of the fund make no express provision for the deduction here in issue, neither the fund nor its administrator can make it. Should either of them do so, the fund would be in breach of at least one of the three conditions for its tax approval status, which may result in the loss of tax advantages for the fund's members and thus less appeal for using retirement annuities that are underwritten by life insurers for retirement planning purposes.

Relief

[36] The complainant's prayer for a refund to her of the remaining amount in her investment account cannot be granted because retirement annuity funds do not allow members to receive benefits therefrom prior to their reaching the age of 55 years. The exception is where the member has become permanently mentally or physically incapable of carrying on his occupation. The complainant does not qualify for such a benefit. She can, however, in terms of rule 5.3 of the new rules of the fund (which apparently came into effect on 1 January 2005 and were approved on 8 April 2005), apply to the board of management of the fund for the transfer of her investment value to another "approved fund", which is defined as "a pension, provident or retirement annuity fund approved as such by the Commissioner in

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SECTION 30M FILING: MAGISTRATES' COURT