



**IN THE TRIBUNAL OF THE PENSION FUNDS ADJUDICATOR
(HELD IN CAPE TOWN)**

CASE NO: PFA/KZN/10396/06/KM

In the complaint between:

N MILTON

Complainant

and

BIDCORP GROUP PENSION FUND

Respondent

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

1. Introduction

- 1.1 The complaint concerns secret profits earned by the respondent's administrator, Alexander Forbes Group (Pty) Ltd ("Alexander Forbes"), through the practice of "bulking" fund investments. The complainant is concerned about the resultant financial loss to the respondent, a registered pension fund, and the consequent prejudice to himself as a member of the respondent. The complainant has included two further complaints relating to housing loans and investment return respectively, which will be dealt with separately in a further determination under case number PFA/KZN/27532/08.
- 1.2 The complaint was received by this office on 31 August 2006. A response was received on 26 February 2007. Additional investigation was conducted by this office, and information pertaining to the practices complained of (as well as the steps subsequently taken to rectify the situation) was solicited from, and provided by, Alexander Forbes. The respondent has also filed further submissions in response to requests for information from this office. The complainant was copied with the response but has not filed a reply.
- 1.3 After reviewing the written submissions, I consider it unnecessary to hold a hearing in this matter. The determination and reasons therefor appear below.

2. Background

2.1 The complainant is a member of the respondent, which is an occupational pension fund registered in terms of the Act. Due to substantial media exposure in recent years concerning undisclosed profits made by service providers in the course of their administration of pension funds, several complaints have been filed with this tribunal by fund members, or former fund members, questioning whether their fund values or exit benefits have been affected by these practices.

2.2 The service provider concerned, in this case Alexander Forbes, has embarked on an extensive repatriation exercise and has put together a scheme to re-imburse all affected funds. It was approached by this tribunal for an explanation of its methodology in identifying the undisclosed profits made, as well as the proposal for re-allocation of those monies to the various funds involved. In most cases settlement offers have already been made to the funds by Alexander Forbes, and many of those settlement offers have been accepted by the trustees of the funds concerned. The methodology and other pertinent information is set out below in the section dealing with the response.

3. The complaint

3.1 The complainant is currently an active member of the respondent.

He commenced employment more than 25 years ago with South African Stevedores, a division of the Rennies Group of companies, which was subsequently taken over by (or renamed, it is unclear on the facts in the complaint or the response) Bidfreight Port Operations, a division of the Bidvest Group of companies. As a consequence of his employment he became a member of the Rennies Group Pension Fund, and later the respondent.

3.2 The proper citations of the corporate entities concerned, and the dates of conversion or transfer from one fund to the other, have not been furnished by the complainant. However, since the respondent itself admits that the complainant has been a member of it since September 1999, (and, inexplicably in another part of the response, for more than 25 years) it can be accepted that the complainant was a member of the respondent at the time that the conduct complained of was occurring, as will become evident from the facts set out below.

3.3 The complainant states that he was disturbed to read in the media of the unlawful practices exposed at Alexander Forbes in relation to bulking of accounts. He would like this tribunal to “investigate the matter”, as he has been with the company (presumably the Rennies / Bidcorp stable of companies) for 25 years, and as a result has a significant investment in the respondent.

4. Explanation furnished by Alexander Forbes

4.1 In order to provide a contextual background to the many complaints concerning bulking and secret profits, this office requested from Alexander Forbes an outline of its methodology for identifying the affected funds, and for effecting redress. The following paragraphs constitute a summary of a report prepared for this purpose by Fiona Renton of Alexander Forbes.

Bulking and secret profits

4.2 “Bulking” is the term used to describe the practice by Alexander Forbes (and other administrators of retirement funds) of notionally combining each fund’s current account balance with the current account balances of other retirement funds administered by Alexander Forbes in order to secure a preferential rate of interest from the bank account concerned. At all times, funds have retained a bank account in their own name and at no time has bulking affected the balances held in the accounts. However, for the purpose of bulking, funds’ current account balances were notionally added together. This resulted in the banks giving each fund a higher rate of return, as the interest rate was based on the aggregated balance. That higher rate of return was then credited to each fund’s own bank account. As this practice is beneficial to funds and their members, the practice continues today.

4.3 However, Alexander Forbes historically received income from the banks for facilitating this practice, which was not disclosed to funds. The calculation of the income earned by Alexander Forbes from the banks took on different forms with different banks and also differed in arrangement with the same bank over the years. Alexander Forbes ceased earning this income from the banks in September 2004.

Total settlement amount (“top down approach”)

4.4 The total settlement amount due to all clients by Alexander Forbes in respect of undisclosed income earned from bulking is R364 million as at 31 July 2006. This amount is made up of the total income earned from the banks over the period, net of corporate taxes plus compound interest. It was reached by analyzing historical records, including estimates supported by trend analysis for certain isolated months in earlier years where complete information was not available. In determining this amount, Ernst & Young, an independent firm of auditors, provided a factual findings report regarding the calculations performed by Alexander Forbes. This report has been provided to the funds.

4.5 The R364 million includes all income earned from mid-1996 up until 30 September 2004 when the practice was terminated. It is not possible to determine exactly when the practice started and

what form it may have taken prior to 1996. Based on documentary evidence, it would appear that the practice of receiving income in the manner described above commenced in 1996. On the available information, income received prior to 1996 would have been minimal.

Individual fund settlements (“bottom up approach”)

- 4.6 Alexander Forbes then calculated each fund’s own unique settlement amount, ie its share of the R364 million. Various methodologies were explored to calculate the fund specific settlements before deciding on the final methodology to divide it across the approximately 1700 funds affected. The method settled on seeks to distribute the total settlement amount in a consistent, reasonable and equitable manner back to the funds.
- 4.7 The settlement amount in respect of each fund is equivalent to the additional interest that the fund would have earned had the bank paid a top corporate cash management rate of interest, less Retirement Funds Tax, plus compound interest.
- 4.8 The aggregate of all the individual fund settlement amounts comes to approximately R364 million. i.e. the top down and bottom up approach give the same result. The detailed steps involved in the bottom up approach are as follows:

- The average balance of each fund for each month over the period during which Alexander Forbes received income from the banks (approximately 10 years) is calculated. This is determined by extracting the Rand value of the actual current account interest earned for each month from the general ledgers of each fund for the period under review. This monthly interest amount is then divided by the actual interest rate for the relevant month to arrive at the average balance for the month.
- Once the monthly average balances have been determined, a “benchmark” rate of interest is applied to this to determine the benchmark interest Rand amount for that fund for the applicable month. These “benchmark” monthly interest rates are the benchmark corporate cash management rates for each size category of balance (as provided by the banks for their preferred clients). The difference between the amount so determined and the actual interest received by the fund (across all months) will constitute the basic amount of the proposed settlement.
- The basic settlement amount is increased with compound interest at the benchmark rate to 31 July 2006, being date of calculation, and then adjusted for the notional deduction of Retirement Funds Tax.

- In addition, from 31 July 2006 to date of actual payment of the settlement to the fund, Alexander Forbes is paying the fund actual interest on the amount at the normal prevailing cash management rate.

4.9 Ernst & Young were also appointed to provide a factual findings report in respect of the client interest earnings over the period. Furthermore, they performed procedures and reported their findings with regard to the calculations and proper application of the settlement proposal to individual clients. Ernst & Young are not auditors to the Alexander Forbes Group.

4.10 Alexander Forbes confirms that every settlement in respect of bulking is based on the methodology disclosed in its offer, which applies consistently to all funds which are part of the bulking settlement arrangement.

Specific settlement with respondent

4.11 In the case of the respondent fund in this particular complaint, Alexander Forbes has further indicated that a settlement offer in an amount of R2 122 438 was accepted by the respondent in 2002, and that a further amount of R256 342 was accepted in June 2007 in settlement of all claims arising from secret profits made from the bulking of accounts.

5. Response

5.1 The respondent confirms that the complainant is a current member employed at Bidfreight Port Operations which is part of the Bidvest Group. The respondent is a defined benefit fund and a defined contribution fund. The complainant is a member of the closed defined contribution class applicable to members who transferred in from the Rennies Group Pension Fund in September 1999.

Bulking and undisclosed fees

5.2 The respondent claims that it only became aware of the bulking fees earned by Alexander Forbes from the bank in 2002. When the information came to the respondent's knowledge, it stopped the practice. It confirms that it entered into a settlement agreement by Alexander Forbes, and, as a consequence, monies were paid to it.

5.3 The response proceeds to describe the practice of bulking, and confirms that the respondent's current accounts were part of the Alexander Forbes bulking arrangement. The respondent was a Nedbank client, and the value held in its current accounts administered by Alexander Forbes represented a small percentage of the respondent's total asset base.

5.4 It records further that Alexander Forbes confirmed that it earned a

variable fee from the bank for the bulking arrangement. It earned this fee for the period 1996 to September 2002. It was this fee that was not disclosed to the respondent as well as to other funds whose assets were bulked. In respect of the respondent's current accounts, Alexander Forbes stopped earning a fee from the banks altogether in September 2002.

- 5.5 In respect of the period of relevance to the complainant, undisclosed fees for bulking took place from 1 September 1999 to September 2002 when Alexander Forbes ceased the practice. Since the respondent did not become aware of the situation until 2002, the trustees were not in a position to give their consent to the undisclosed fees.

Duties of trustees

- 5.6 The respondent then deals with the duties of trustees. To determine whether there is any liability on the respondent to pay any settlement amount to the complainant in respect of the recovered undisclosed fees, it is contended that it is important to consider whether there was any wrongdoing that resulted in the complainant suffering loss in respect of which the respondent is liable to pay him.
- 5.7 The respondent concedes that the trustees of a fund owe a fiduciary duty to the fund and to its members and other beneficiaries. These duties are clearly established in terms of

common law, case law, and statute, the most important legislative sources being the Pension Funds Act and the Financial Institutions (Protection of Funds) Act 28 of 2001. Trustees have certain duties under section 7C of the Pension Funds Act. This section prescribes that the object of a board “shall be to direct, control and oversee the operations of a fund in accordance with the applicable laws and the rules of the fund.”

5.8 Sections 7C and 7D of the Act are essentially a codification of the broad duties of trustees at common law. They clearly include the obligation to ensure that a fund is properly administered and its assets prudently invested in such a way that the interests of the fund and its members are protected. The respondent submits that the trustees have taken appropriate steps to ensure that its interests, and those of its members, are protected.

5.9 The respondent has bank accounts administered by its administrator, Alexander Forbes, which are current accounts used for the day-to-day operational requirements of the fund. The majority of the respondent’s assets are invested by specialised investment managers and not by Alexander Forbes.

Steps taken by the trustees

5.10 The respondent has set out the contractual arrangements between itself and its administrator as well as all actions taken by its trustees to monitor the arrangements.

- 5.11 The respondent has had an administration agreement with Alexander Forbes since inception of its administration of the respondent. One of the trustees' duties is to ensure proper compliance by Alexander Forbes of its duties pursuant to the service agreement. It is contended that the trustees took all reasonable steps to ensure that satisfactory banking arrangements were secured for the respondent by Alexander Forbes.
- 5.12 The trustees acted responsibly in having Alexander Forbes open and operate the respondent's banking accounts as part of its administration duties. The fact that Alexander Forbes opened and operated the accounts was, undoubtedly, the cause for the opportunity of bulking and the concomitant benefits. In the circumstances, there cannot be a charge that the trustees ought to have secured bulking without Alexander Forbes. Alexander Forbes did secure a favourable rate of interest for funds.
- 5.13 The respondent also requested Alexander Forbes to verify all amounts paid into the respondent. The profits retained by Alexander Forbes in connection with the bulked accounts, was, in the nature of secret profits, not disclosed to the trustees.
- 5.14 The respondent concludes that there has not been any wrong doing in respect of the conduct of the trustees. They acted in all respects in the best interests of the members by securing an administration services agreement, which specifically provides how the respondent is to be administered. The fee for doing so

was disclosed and agreed to by the fund. When the retention of additional and secret profits came to light, the trustees took all necessary steps to ensure recovery of the retained monies.

Nature of settlement proceeds

- 5.15 It is the respondent's submission that the settlement agreement with Alexander Forbes novates prior claims arising from the profits from bulking. As such the amounts received in settlement accrue to the respondent on acceptance of the settlement offer. It submits that this is neither a refund of fees, nor is it a repayment of interest. It is further contended that once the amount has been paid to the respondent, it is up to the respondent to decide how to deal with the money and to whom to distribute it, if it does decide to distribute it. Any payment made has to be in accordance with the rules of the fund, which rules do not provide for payment of bulking amounts to members and/or former members.
- 5.16 In the present case, it is submitted, the settlement amount accrued to the respondent. There was no conclusive decision taken by the trustees with regard to allocation at the time the first settlement was accepted in 2002, and as such the recovered profits just formed part of the general reserves of the respondent. The complainant has, according to the respondent, therefore already benefited from (or may in future benefit from) subsidisation of costs and/or a greater allocation towards retirement funding of amounts drawn from the general reserves.

Legal grounds for a claim for payment

- 5.17 The respondent then goes on to explore the possible basis for a claim for payment by the complainant.
- 5.18 It examines firstly whether there is any principle of law that allows the complainant to institute a claim on the basis of a disappointed beneficiary. It assumes that such a claim would be brought directly against Alexander Forbes. The principle involved here, according to the respondent, arises from the respondent's contractual relationship with Alexander Forbes. If the latter breaches its contract with the former to the financial detriment of the complainant, who is a beneficiary of the respondent, a claim may lie.
- 5.19 However, the respondent submits that no such claim can be brought against the administrator in addition to a claim against it by the respondent itself. In addition, it contends that the complainant did not suffer any economic loss. He is still a member of the respondent, and, on exit, is only entitled to a benefit in accordance with its rules.
- 5.20 Secondly, the respondent explores a possible action in delict based on the respondent's alleged wrongful acts. The response is not entirely clear on this aspect, but it seems to imply that there was nothing wrongful about the respondent's conduct, nor did it cause any harm to the complainant.

5.21 On 15 February 2008, a letter was addressed to the respondent by this office in order to establish whether any decision had yet been taken with regard to application of the amounts received in settlement. The letter reads as follows:

“We understand that you accepted an offer in an amount of R2 122 438 in 2002 and an additional amount of R256 342 on 29 June 2007 from Alexander Forbes in settlement of all claims arising from secret profits made from the bulking of accounts. By now the trustees would undoubtedly have decided how to utilise the proceeds.

1. Kindly advise us of the decision taken.
2. Please indicate the factors considered in arriving at this decision.
3. Please furnish the supporting documentation in the form of the resolution, minutes etc recording it.
4. Please also advise, in the event that any portion of the proceeds were allocated to members or former members, whether the complainant was included in the distribution, and if not, the reason for his exclusion.

Please ensure you respond **within two weeks** of date hereof.”

5.22 A reply was received enclosing the following excerpt from the minutes of two trustee meetings held on 6 September 2007 and 21 November 2007 respectively.

5.23 The minutes of 6 September 2007 state:

“4.2. Alexander Forbes (item 4.3. of the minutes of the seventy first Pension Fund meeting)

The Trustees noted that the final bulking settlement letter had been signed on June 28 2007, subsequent to confirmation from Alexander Forbes that due to the settlement offer not being accepted prior to the final Retirement Fund Tax submission to SARS in May 2007, no liability for the payment of Retirement Fund Tax on the interest portion of the final settlement value had been incurred.

The Trustees further noted that the settlement amount of R 275 619,20 was paid into the Fund’s account on June 29 2007 in addition to the amounts received by the Fund in 2002.

The Trustees further noted that although it had been agreed at the previous meeting that the amounts received would be allocated to the member surplus account, the Chairman had requested that the decision be revisited.

The Consultants explained the proposed Alexander Forbes methodology and process to be followed should the Trustees wish payment to be made to current and former members.

The Trustees agreed that the settlement amount should

be paid to the relevant members and former members in accordance the Alexander Forbes' proposed methodology.

The Consultants raised the issue of the pending Adjudicator cases pertaining to the bulking issue and the fact that the Adjudicator had responded to the Fund's initial response raising further queries. After discussion, the Trustees requested that the Consultants obtain legal opinion as to whether or not the Fund should make payments to members and former members in terms of the bulking settlement received or if the Fund should wait until the Adjudicator had given a ruling on the outstanding cases."

5.24 The minutes of 21 November 2007 state:

"4.2. Alexander Forbes (item 4.2. of the minutes of the seventy second Pension Fund meeting)

The Trustees noted that the Consultants had

- forwarded the Pension Fund's response, to the additional queries received on the Adjudicator cases pertaining to the bulking issue, to the Adjudicator on October 19 2007 (copy had been sent to the Trustees on October 25 2007)
- obtained a legal opinion advising that the Fund postpone the payment of the bulking

settlement values to members and former members until the Adjudicator had given a ruling on the outstanding cases.

The Consultants advised that as a result out [sic] of the Ernst & Young's investigations into Alexander Forbes Business Practices, additional payments would be made to the Fund and relevant stakeholders due to historic non disclosure of income.

The Trustees noted that further details would be forwarded to them once the calculations and investigations had been completed.”

5.25 Despite receipt of the settlement proceeds (the substantial portion of which was paid to the respondent in 2002), it therefore appears that no decision concerning the application of the funds has yet been taken.

6. **Determination and reasons therefor**

Bulking complaints lodged with this tribunal

6.1 The various complaints filed at this office pertaining to secret profits made from bulking have arrived in all shapes and sizes. Some contain detailed allegations and extensive annexures. In others, like the case under discussion, the complainant raises the suspicion that he may have been prejudiced. Similarly, some

complaints are clearly directed at Alexander Forbes, or other fund administrators, as respondent, while other complainants look to the fund of which they are or were a member for satisfaction. There are also complaints filed by funds against their administrators.

- 6.2 The remarks below are intended to cover the situation where a member or former member lodges a complaint against either a fund or an administrator of that fund in which he alleges that the practice of secret profits from bulking has been to his prejudice.

Legal basis for complaint

- 6.3 The legal construction to be placed on such a complaint is that there is a contractual relationship between the administrator concerned and the fund in terms of which the administrator is obliged to account to the fund for all profits that accrue to the administrator as a consequence of the execution of its contractual mandate to the fund. Put differently, the administrator is not entitled to make a secret profit in the course of its administration of that fund. As a consequence of the law of agency any such undisclosed profits fall to be accounted for and repatriated to the fund. (See *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168 at 229. For a more detailed exposition of the liability of an administrator to refund secret profits, see also *Dollman v Irvin and Johnson Retirement Fund and Another*, case number PFA/WE/13155/07/KM, an as yet unreported

determination of this tribunal.)

- 6.4 It would be exceedingly difficult for a complainant to rely on a direct action against an administrator, since his claim (if any) would lie in delict. As a consequence, he would have to prove actual financial loss, which, in most cases, would be almost impossible. It is therefore preferable for grievances of this nature to be construed as a complaint against the fund, alleging that it is incumbent on the fund to recover any profits due to it as a result of bulking practices for the benefit of its members.
- 6.5 In complaints like the present, it seems that there are two possible bases on which an aggrieved member can seek redress against a fund. Both of these grounds flow from the definition of a complaint set out in section 1 of the Act, and, in particular, a complaint relating to the administration of a fund, alleging that the complainant has or may sustain prejudice in consequence of the maladministration of the fund by the fund or any person, whether by act or omission.
- 6.6 The first is where the member can show that the fund either failed to recover secret profits where they were due, or failed to recover the full extent of them in circumstances where it ought reasonably to have done so.
- 6.7 The second is where the member can show that the manner in which such recovered profits were utilised was unreasonable, or

that any scheme of distribution of such profits was unreasonable.

- 6.8 With regard to the first basis of attack, I have purposefully set out the memorandum by Alexander Forbes in some detail as it gives a very thorough explanation of how the settlement figures were arrived at, and the methodology employed in establishing the amounts owing to each fund. It will therefore be insufficient for a complainant simply to place the amount recovered in dispute, or to allege that the trustees ought to have obtained a more favourable settlement. The complainant in such a case will have to substantiate in what respect the trustees erred and why such settlement was unreasonable.
- 6.9 In the present case, there is nothing before me to suggest that the respondent recovered less than what was owed to it by its administrator, or that the trustees failed to take reasonable steps to satisfy themselves that the interests of the respondent and its members were adequately protected.
- 6.10 The second possible basis for a complaint relates to the application of the recovered secret profits. The uncontested evidence shows that the respondent has recovered an amount of R2 378 780 from its administrator. The evidence also shows that, to date, it has failed to take a decision with regard to how to apply the resources. The substantial portion of the recovery was made in 2002, so there is no question of the trustees having had insufficient time to apply their minds to this matter. On the

contrary, the minutes from the trustee meetings make it clear that the trustees have postponed any decision until further clarity is obtained through rulings from this tribunal.

- 6.11 I have a measure of sympathy for the trustees of the respondent, who find themselves in untested legal territory and are understandably hesitant to make a decision which later rulings by this tribunal or other competent authorities may subsequently call into question. However, their inaction on this issue does amount, in my view, to maladministration of the respondent. The potential prejudice to the complainant, and others in his position, arises from the unjustifiable deferment of a decision which may well result in financial benefit to him, no matter how small that benefit may be.
- 6.12 The board of trustees, in accordance with its statutory mandate of governing the respondent, is obliged to decide how best to utilise those financial resources. There is no guarantee that members or former members will be entitled to share in them, and an allocation to a general reserve may well be a reasonable decision, dependent on specific factors and circumstances.
- 6.13 In appropriate cases the respondent may formulate a scheme for distribution of any profits once they have been recovered. Such scheme must be reasonable, but that does not necessarily mean that every potential beneficiary will or must be included. The following circumstances are examples of factors that may be

taken into account in deciding on a scheme for distribution:

- the amount available for distribution;
- the financial position of the fund;
- the pool of potential beneficiaries and the cost of distributing to some or all of them; and
- the time period over which the secret profits were retained by the administrator in relation to beneficiaries' membership of the fund.

6.14 The above is not an exhaustive list, and no doubt funds in this position will have recourse to the general principles that guided both the statutory apportionment schemes and the demutualisation profits that accrued to many funds in the late 1990's and early 2000's.

6.15 What is necessary, however, is that the trustees in exercising their discretion as to the application of such funds, apply their minds properly to the issue and consider all relevant factors.

6.16 In its response, the respondent has raised the question of the time of accrual of the proceeds. I refrain from expressing a view on the correctness of the advice furnished to the respondent (that the monies accrued on date of acceptance of the settlement) as it is

not relevant for purposes of this determination. It is obviously necessary to establish the time of accrual, and the nature of the proceeds for purposes such as Retirement Fund Tax. I understand this may also be of relevance to the possibility of further recoveries from Alexander Forbes as a consequence of the tax-deductible status of its repayments, depending on the view that SARS takes of the matter.

- 6.17 Whatever the legal position on this aspect, it does not mean, in my view, that the respondent should not take a broader view of the historical source of the funds for purposes of allocation. In this regard, too, it might be mentioned that the respondent's reliance on the lack of an empowering rule as precluding distribution to members or former members is misplaced. There is nothing to prevent the trustees from effecting an appropriate rule amendment to provide for any distribution they may elect to implement. Such exercises were routinely undertaken by funds during the demutualisation distributions, and in respect of surplus arising subsequent to the statutory apportionments.
- 6.18 I am accordingly of the view that the board of trustees of the respondent must be directed to exercise its discretion as to the application of the recovered undisclosed profits within a specified time-frame, and I shall make an order to that effect.
- 6.19 Once that decision has been made, and communicated to the complainant, he will be free to lodge a further complaint in the

event that he is dissatisfied with the decision. In this regard, however, I would encourage him to read carefully the relevant paragraphs above with a view to what he would need to establish in order to be successful.

6.20 Finally, I would like to avoid the danger of creating unrealistic expectations on the part of the complainant, and others in a similar position. The complainant seems to think that he has been deprived of a significant portion of return on his retirement investment. This is clearly an exaggerated perception. While the settlement figure of over R2 000 000 may sound substantial in the abstract, this amount was incurred over a three year period in respect of a very large pension fund with extensive assets. The impact on individual members' investments is not likely to be appreciable.

7. **Relief**

7.1 I make the following order:

7.1.1 The respondent is directed to allocate the amounts received from Alexander Forbes in settlement of its claim for undisclosed profits **within 8 weeks** of date hereof.

7.1.2 The respondent is further directed to advise the complainant in writing of the decision taken in 7.1.1 above, together with reasons therefor, **within two weeks** of making the decision.

DATED AT CAPE TOWN ON THIS THE DAY 2008.

MAMODUPI MOHLALA

PENSION FUNDS ADJUDICATOR