



HEAD OFFICE
Johannesburg
1st Floor, Norfolk House
Cnr 5th Street & Norwich Close
Sandton, 2196
PO Box 651826, Benmore, 2010
Tel (011) 884-8454 □ Fax (011) 884-1144
E-Mail: enquiries-jhb@pfa.org.za

Cape Town
2nd Floor, Oakdale House, The Oval
Oakdale Road, Newlands, 7700
P O Box 23005, Claremont, 7735
Tel (021) 674-0209 □ Fax (021) 674-0185
E-mail: enquiries@pfa.org.za
Website: www.pfa.org.za

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DETERMINATION IN TERMS OF SECTION 30M OF THE PENSION FUNDS ACT, 24 OF 1956 (“the Act”): A. HARRIS v CENTRAL RETIREMENT ANNUITY FUND (“the fund”) and SANLAM LIFE ASSURANCE LIMITED (“Sanlam”)

Introduction

[1] Having examined and investigated the complaint received by this office on 9 May 2005, I consider it unnecessary to hold a hearing in this matter. My determination, together with reasons therefor, is set out below. In December 2005 an announcement was made of a Statement of Intent between the Minister of Finance, on the one hand, and the Life Offices Association and five large life assurers on the other, in terms of which the life assurers would commit themselves to certain minimum standards in respect of retirement annuity funds and endowment policies. Although the statement is not binding on this office, we nevertheless referred all retirement annuity fund complaints (including this one) back to the management boards and life assurers administering these funds with a view to facilitating an amicable resolution of the complaint between the parties without the intervention of this office. This matter was referred for settlement to the fund on 20 January. The parties were given 30 days to settle the matter failing which this office would determine the complaint in the ordinary course. Many complaints were settled on this basis but the settlement terms were not divulged to this office. However, on 16 February 2006 we were informed that the parties in this complaint had failed to reach a settlement in this case. The details of disagreement were not communicated to us. It is with that brief background that we now determine this complaint in the ordinary course.

V Ngalwana (Adjudicator), N Jeram (Deputy Adjudicator), C Nkuhlu (Snr Assistant Adjudicator), L Shrosbree (Snr Assistant Adjudicator), Z Camroodien (Snr Assistant Adjudicator), F Mtayi (Snr Assistant Adjudicator), K MacKenzie (Snr Assistant Adjudicator), N van Coller (Assistant Adjudicator), L Mbalu (Assistant Adjudicator), R Maharaj (Assistant Adjudicator), J Mabuza (Assistant Adjudicator), V Abrahams (Assistant Adjudicator), S Gcelu (Assistant Adjudicator), T Thabethe (Assistant Adjudicator)

Office Manager: L Manuel

Complaint

- [2] Your complaint concerns the value of your retirement benefit from the fund, which has been significantly eroded by penalties applied on replacement of policy and advancement of retirement date.
- [3] You claim that you initially joined the fund in 1990 while working with Plan Associates, the employer choosing a retirement annuity fund as a pension vehicle for its employees, since this afforded them the opportunity of continuing with their membership after leaving employment. According to your calculations, you contributed an amount of at least R14 000 prior to 1996, and thereafter a total of R43 400 which you established from your tax certificates.
- [4] You elected to advance your retirement date and exited the fund in October 2004 (December 2004 according to the fund). You state that your retirement benefit only amounted to about R30 000, of which R10 000 was paid in cash, the balance being used in production of a monthly pension of R148.
- [5] You request that this matter be investigated, as you cannot understand how there has been negative growth over the years.

Response

- [6] The fund contends in its response that the grievance concerns long-term insurance business and not pension fund business, and therefore does not amount to a complaint for purposes of the Act.
- [7] On the merits it states that an initial policy was taken out on your behalf on 1 April 1993 (April 1991 according to the policy document), which was subsequently cancelled and superceded by a new policy. You had originally selected a retirement date of 1 May 2013, but subsequently advanced this to 1 December 2004. The final amount payable was R31 991, R10 664 of which you elected to receive as a cash benefit, the balance being used to purchase an annuity. The debits and credits in your share account were expressed as follows:

“Conversion amount carried forward	R50 398
Plus: Total paid-in premiums	R11 711
Less: Total risk premiums	R 6 500
Less: Total policy fee and administration charges	R 1 358
Equals: Total premiums available for investment	R54 251
Less: Negative investment return	R15 637
Equals: Fund value prior to advancement of maturity value	R38 614

Less: Fee for advancement of maturity value R 6 623
 Equals: Advanced maturity value on 1 December 2004 R31 991"

- [8] The fund was asked to furnish further information on the initial policy which had been replaced and whether any penalties had been levied in respect of this. It was also asked to indicate in terms of which rule or policy provision the advancement of retirement penalty was applied. The fund was also requested to furnish a more detailed account of the costs debited against your investment share account.
- [9] The following table was supplied in respect of the expense account (which amounts were debited against your share account):

"Analysis of Outstanding Expenses as at 26/11/2004

Build Up of the Outstanding Expenses on policy number 18216319x6

	A	B	C	D	E
Date	Initial Expenses	Recurring Expenses	Interest	Cost Recoveries	Outstanding Expenses
May 01	Carried over from policy 13258584x5				8331.53
May 01	1091.44	276.91	0.00	1068.12	8631.76
May 02	1932.28	487.44	1503.67	1471.05	11084.10
May 03	651.55	455.45	-4649.78	1214.89	6326.43
May 04	487.60	531.17	1388.65	1435.99	7297.86
26 Nov 04	-228.58	-221.33	-659.75	-74.60	6262.80

Note: Outstanding Expenses = A+B+C-D"

- [10] This was then summarized as follows:

"Analysis of the Outstanding Expenses as at 26/11/2004

Carried over from policy 13258584x5	8331.53
<i>plus</i> Initial Expenses	3934.29
<i>plus</i> Recurring Expenses	1529.64
<i>plus</i> Interest	-2417.21
<i>less</i> Cost Recoveries	5115.45
<i>equals</i> Unrecovered expenses	6262.80

- [11] In amplification of the outstanding expense account, the fund explained that initial expenses incurred at the inception of the policy consist of sales, marketing and issuing expenses. In addition to this, expenses are incurred

whenever the premium on the policy increases. Therefore an amount for these expenses also appears for each policy year. The expenses allocated to the policy are recovered over the term of the policy by means of the policy charges. The recurring expenses for a policy year are the administration expenses incurred on the policy during the course of that year. Since the expenses (both issuing and recurring) are not immediately recovered, interest is added to the unrecovered amount. The interest is derived from the investment return on the fund in such a way as to be return-neutral to the policyholders. Therefore if investment returns are negative, the interest added to the unrecovered expenses will also be negative, as in the present case.

- [12] The fund contends that the consequences of terminating the monthly premiums had been explained in the Policy's "Description and Provisions" as follows:

"Choice of maturity date

4. According to paragraph of "Description and Provisions", the maturity date of the policy may be changed to any date after the fifty-fifth and before the seventieth birthday of the assured. Sanlam shall then determine the adjusted benefits that can become available."

- [13] According to the fund this clearly refers to the penalty applied on advancement of the maturity date. In respect of the replacement of the initial policy, the fund stated that no penalty was applied, and that you were placed in the same position as you were prior to the conversion of the older policy.
- [14] On the question of investment performance, the fund draws attention to the fact that approximately 10,5% of the total contributions were applied to risk benefits. The net investment amounts were invested in Sanlam Life's Offshore Equity Fund. Large proportions of this fund are invested in foreign equities and the fund is US dollar based. Consequently, the performance of both offshore markets and the Rand/US dollar exchange rate played a vital role in the performance of this fund. Since the composition of this fund is similar to that on which the MSCI World Index is based, this index is used as a benchmark against which to measure the performance of the Offshore Equity Fund. The MSCI Index dropped by 17% over the period from inception until advancement of the maturity date of the complainant's retirement. Simultaneously the Rand strengthened by 25% against the US dollar. This indicated an expected negative return on the net investment amounts over this period (1 May 2001 until 1 December 2004) of around 40%. The fund submits that the performance of its underlying offshore investments is consistent with this.
- [15] It therefore contends that your benefit has been correctly calculated.

Determination and reasons therefor

- [16] There is no merit to the preliminary point raised by the fund. The crux of this complaint does not constitute long term insurance business, but actually relates to a retirement annuity fund, which is a pension fund organization as defined in the Act. For the reasons more fully set out in *JJ Schwartz v Central Retirement Annuity Fund & Another* [2005] 5 BPLR 435 (PFA) at paragraphs [12] to [28] and *Louw v Central Retirement Annuity Fund & Another* BPLR [2005] 7 BPLR at paragraphs [17] to [36], I cannot uphold the contention that this matter constitutes “long term insurance business” over which I have no jurisdiction.
- [17] Furthermore, Davis J (in whose judgment Le Grange AJ concurred) in *Central Retirement Annuity Fund v Adjudicator of Pension Funds and others* [2005] 8 BPLR 655 (C) at 660C - E (handed down on 20 October 2005) (“the de Beer judgment”) confirmed the jurisdiction of this office and stated:
- “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 illusory ‘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.”
- [18] Furthermore in so far as your complaint implicitly relates to the administration of the fund and/or the investment of its funds and it is implicit therein that you have suffered prejudice (in that your fund value has been drastically reduced) in consequence of the maladministration of the fund (in the form of the levying of undisclosed charges), your grievance constitutes a complaint as defined. (See *Louw* at paragraphs [11] to [15].
- [19] On the merits, it appears that the investment portion of your retirement funding was substantially reduced by the cost of risk benefits. That is a cost to which you agreed, and was therefore lawfully deducted from your contributions.
- [20] I now turn to the provisions on which the respondents rely for effecting the deductions in respect of cessation of contributions and early retirement.
- [21] Rule 2 of Part 7 provides:

“2. A MEMBER’S CONTRIBUTIONS are payable during the period determined in the POLICY issued on his life.

If a MEMBER's CONTRIBUTIONS cease after he has already paid sufficient CONTRIBUTIONS so that the POLICY issued on his life has a paid-up value in accordance with the practice of the ASSURER, the ASSURER converts the POLICY to a paid-up POLICY for reduced benefits. The MEMBER will then have the right to apply for reinstatement of his benefits, partially or in full, and the MANAGEMENT COMMITTEE in consultation with the ASSURER will consider such a proposal on receipt of....."

- [22] There is no definition of what a "paid-up policy" is in the rules, and certainly no mention that in converting the policy to a paid-up policy for reduced benefits the insurer may charge a "premium termination adjustment" fee. I have not been referred to, nor can I find any authority in the first policy document for such a fee. Although the fund has contended that no penalty was applied in the replacement of your policy, and that you were placed in the same position you would have been in, this is clearly not borne out by the facts. It is evident from the table above that a debit balance of R8 331 was transferred to your present investment share account, the effect of which is precisely the same as a "premium termination adjustment fee". In addition to this "expense" that was carried over to the next underlying investment, you incurred further costs in an amount of R3 934 for the capture of new business. You appear therefore to have been in a manifestly worse financial position after replacement of the initial policy.
- [23] This practice of replacing existing policies with similar policies is usually motivated by a desire to generate further income for the financial intermediaries and the underwriters and is commonly referred to as "churning". It is much to be deprecated. This tribunal has no jurisdiction over financial intermediaries concerning the advice they give, since that falls within the ambit of the FAIS Ombud, Mr Charles Pillai, or the ordinary courts. However, it seems to me that the trustees of the fund, in exercising their fiduciary duties towards members, whose financial affairs they are responsible for managing, may not simply turn a blind eye to such practices.
- [24] The trustees of the fund are, moreover, under a duty to ensure that the terms of any underlying contract taken out in respect of, and for the benefit of, a member are adhered to by the other contracting party. They may not simply wash their proverbial hands of all responsibility. Section 7C of the Act codifies the common law fiduciary duty owed by trustees to the beneficiaries on behalf of whom they hold trust assets. In this sense members are in a similar position to trust beneficiaries. Section 7C provides that the object of a board shall be to direct, control and oversee the operations of the fund in accordance with the applicable laws and rules of the fund.
- [25] There is nothing in the rules or the underlying policy document (or indeed applicable legislation) that allows for the charging of a fee by reason only

of a member ceasing contributions prior to the retirement date.

- [26] As Davis J stated in the *De Beer* judgment (at 660D-E), the fund cannot simply be treated as an illusionary go-between between the members and the insurer. It should be accountable to its members and hence be subject to the discipline of the Act's complaint mechanism. On the issue of the charges levied by the insurer, Davis J stated as follows (at 663E-G):

“It follows that the reasonableness of the total charges levied by the insurers from time to time in respect of the administration of the fund and the apportionment thereof among beneficiaries are considerations of which account must be taken by Applicant's management committee. Similarly, the reasonableness of investments effected and maintained by the insurer for the fund from time to time should be examined by the management committee, if the latter is to fulfill its fiduciary responsibilities to members. In addition, the adequacy of disclosure of information which is critical to the interests of members, such as an adequate and fair explanation as to the meaning of documents which provide illustrative values at the inception of the contract as well as the adequacy of disclosure by the insurer to members from time to time, must, in the light of the analysis advanced, comprise part of the responsibilities of the management committee of applicant.”

- [27] The effective penalty of R8 331 was therefore a deduction which was not authorized by the rules or the policy. Turning to the question of the penalty for advancement of the retirement date, there is similarly no authority in either the rules or the second policy document for the application of an early termination fee. In my opinion “adjusted benefit” does not cover the “unrecouped costs” sought to be recovered from the benefit.
- [28] As matters stand therefore, neither the rules nor the policy documents authorize the insurer to charge a policy alteration fee on either replacement of the policy or on retirement earlier than initially indicated.
- [29] As regards the question of investment performance, off-shore portfolios always contain the risk of markets moving against the investor. From the response received I cannot find that there was any negligence on the part of the fund, since it appears to be in line with benchmark performance. This aspect of the complaint cannot succeed. It is insufficient to show that the fund has not performed as well as could have been hoped. It is necessary to establish that the investment decisions of the board were negligent in some respect or that inappropriate investment strategies were pursued. I have found no evidence of this in the course of the investigation.

Relief

- [30] I therefore make the following order:

- [30.1] It is hereby declared that the respondents were not entitled to debit your investment account with R8 331 on replacement of the underlying policy, nor were they entitled to deduct R6 262 from your benefit on advancement of the retirement date;
- [30.2] The respondents are jointly and severally directed to calculate the retirement benefit which you would have received had the aforesaid deductions not been effected;
- [30.3] Sanlam is further ordered to pay to you, or transfer to an institution of your choice permitted by the rules and applicable legislation, the amount in paragraph [30.2] less any payments made and any deductions permitted in terms of the Pension Funds Act, within six weeks of the date of this ruling;
- [30.4] Sanlam is ordered further to pay interest on the amount of the payment or transfer in paragraph [30.3] at the *mora* rate of 15,5% per annum reckoned from date of levy of the charges to date of transfer or payment.

DATED AT CAPE TOWN ON THIS THE DAY OF 2006.

Yours faithfully

VUYANI NGALWANA
PENSION FUNDS ADJUDICATOR