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PFA/KZN/2911/2005/SG

Re: DETERMINATION IN TERMS OF SECTION 30M OF THE PENSION FUNDS ACT, 24 OF 1956 ("the Act"): N Webb v Central Retirement Annuity Fund ("the fund") and Sanlam Life Insurance Limited ("Sanlam")

Introduction

[1] This matter concerns the reduction of the investment value of a member of a Retirement Annuity Fund as a result of the levying of a charge for the termination of contributions to the fund. The complaint was received by this office on 30 March 2005, and a letter acknowledging receipt thereof was sent to you on 21 April 2005. The response was received by this office on 20 May 2005. After considering the written submissions before me, I consider it unnecessary to hold a hearing in this matter.

[2] 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 19 January 2006. 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. On 22

February 2006 you informed this office that the fund made you an offer which you did not accept as you consider it inadequate to make up for the financial prejudice you suffered. I shall now determine this complaint in the ordinary course. My determination and reasons therefor appear below.

Factual Background

[3] On 1 March 2002, you became a member of the Central Retirement Annuity Fund ("the fund") which is administered by Sanlam Life Insurance Limited ("the insurer"). The elected contractual maturity date was 1 March 2020. Your initial monthly contribution to the fund was R2 800.00 which was to increase by 10% on 1 March of each succeeding year. In 2004, you were in financial predicament which rendered you unable to continue the monthly contributions. On 1 February 2005, you ceased making payments.

[4] The fund value before you ceased making contributions was R85 968. The insurer deducted a "premium termination fee" of R38 807. This left the fund value of R47 161 immediately after the deduction of the "premium termination fee".

The complaint

[5] You are aggrieved by the levying of a "premium termination fee" of R38 807 against your investment value and are contending that you were not informed when you joined the fund, that penalties would be imposed upon the early termination or reduction of contributions.

The responses

Technical points

[6] The fund and the insurer have raised two technical points in response to the complaint, and have also dealt with the merits. The first technical point is that this is not a "complaint" as defined in the Act as it is not "about the execution of duties by the Fund (or administrator)" but is in effect "about the execution of duties by the insurer under the policy - namely about a matter domestic to the policy, notably the actuarial substructure of the policy, which constitute "long-term insurance business" as defined in, and regulated under, the Long-term Insurance Act.

[7] The second technical point is that because this complaint is "not about "maladministration of the Fund" by the fund (or the administrator), it is not a "complaint" as defined in the Act.

Merits

[8] The fund contends that the "premium termination fee" is not a "penalty" as such. It states that it is the alteration fee that was charged for making the policy fully paid-up .To advance its contention it seeks to rely on a clause which authorizes the levying of a premium termination fee consisting of the foreign currency equivalent of R200.00, a percentage of the value of the policy investment and a percentage of the savings premium in the event that the recurring premium is stopped.

[9] The insurer seeks to justify the charging of a "early premium termination fee" by arguing that most of the expenses with respect to policies are incurred at the commencement of the policy, and that if the contributions are not paid for the full contractual term then the insurer is no longer able to recover the costs from future contributions as these have stopped. Further, the insurer contends, in order to recover those expenses that it was precluded from recovering due to the premature cessation of contributions, the insurer reduces the fund value by making an early termination adjustment. The insurer refers to a clause in the policy documents which states that the insurer will determine the available maturity value if the contributions are terminated prior to the contractual maturity date.

Determination and reasons therefor

Technical points

[10] There is no merit in the technical points raised by the respondents. 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 *Schwartz v Central Retirement Annuity Fund and Another* [2005] 5 BPLR 435 (PFA) at paragraphs [17] to [28] and authorities referred to therein and *Louw v Central Retirement Annuity Fund and Another* [2005] 7 BPLR 622 (PFA) at paragraphs [17] to [36]. I cannot uphold the contention that this matter constitutes "long-term insurance business" over which I have no jurisdiction.

[11] 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) ("the *de Beer* judgment") at 660D-E 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 illusionary 'go between' the members such as second respondent and Sanlam Life. It should be accountable to its members and hence be subject to the discipline of the Act's complaint mechanism."

[12] 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 reduced as a result of the levying of a "premium termination fee") your grievance constitutes a complaint as defined (See *Louw v Central Retirement Annuity Fund and Another* [2005] 7 BPLR 622 at paragraphs [11] to [15].

[13] While your letter of complaint does not make the allegations as required in the Act in the precise terms as would otherwise have been expected of a lawyer (which I gather you are not), it is clear that you are unhappy about the charging of a fee without prior warning by reason only of your stopping contributions to the fund. In the circumstances, it would be unduly formalistic to dismiss the complaint by reason solely of failure to allege in precise terms as required by the Act.

[14] Davis J had the following to say in the de Beer judgment in this regard at 660 E - G:

> "Applicant's contention regarding [the complainant's] letter is based upon a very formalistic reading of the complaints procedure as provided for in the Act. On this reading, the letter generated by [the complainant] would not constitute a proper complaint as defined. But this submission ignores the purpose of the Act. The structure of chapter VA of the Act is aimed at ensuring an effective, inexpensive and expeditious resolution of pension complaints by members, many of whom may not be able to afford legal advice and would therefore be compelled to formulate their complaint without any legal assistance or a complete understanding of the intricacies of the legal relationship between the respective parties, as in the case between Sanlam and applicant."

[15] The technical points are dismissed.

<u>The merits</u>

[16] The issue for determination is whether the fund and /or the insurer (in its capacity as the administrator and/or investor of the assets of the fund) are entitled to deduct the expenses and charges from your investment account. The answer must lie in the rules of the fund and the Act. 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.

[17] Section 13 of the Act confirms the binding force of the rules of a fund. As the Supreme Court of Appeal stated in *Tek Corporation Provident Fund and others v Lorentz* [2000] 3 BPLR 227 (SCA) at paragraph [28], the trustees of a fund may do with the fund's assets only what is set out in the rules.

[18] Part 7.1 of the fund rules provides:

> "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….".

[19] 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.

[20] The clause in the policy document which the fund seeks to rely on to justify the charging of the "premium termination fee" provides:

> Can payment of recurring premiums (if applicable) be stopped?
>
> Yes. If the sum to which the value of the policy invested has grown, less a premium termination fee, exceeds the minimum of foreign currency equivalent of R1 500,00, the policy will be maintained without further premium payments. This minimum will increase from time to time.
>
> If premium of recurring premium is stopped before the option date, the premium termination fee currently consists of the following:
>
> - the foreign currency equivalent of R200.00, plus
> - a percentage of the value of the policy investment at the time, plus
> - a percentage of the savings premium at the time (if applicable)
>
> These percentages depend on the size of the savings premium, the amount of the negotiated commission, and when payment of the recurring premium is stopped. At present, if payment of the recurring premium is stopped on or after the option date, no premium termination fee will be charged. We may charge this from time to time."

[21] The above clause which the insurer relies on only allows the charging of a premium termination fee which is the foreign currency equivalent of R200, plus an unspecified percentage pertaining to the value of the policy investment and savings premium at the time of cessation of contributions. Thus, the insurer may not charge a premium termination fee in excess of the foreign currency equivalent of R200. As for the "percentage of the value of the policy investment" and "the percentage of the savings

premium" at the time of the cessation of contributions, the amount in question cannot be determined with any measure of certainty. The reason is that the provision in which they are contained is couched in such vague, imprecise and general terms that it can be interpreted as allowing the insurer to charge whatever percentage of the policy investment and savings premium it chooses: even 100% thereof.

[22] For the reasons set out in *Walters v MM Retirement Annuity Fund & Another* [2005] 8 BPLR 719 (PFA) at paragraphs [26] to [28] the provisions cannot be legally enforced.

[23] I have also been provided with documents setting out the details the "Stratus International Retirement Annuity". Page 2 of the document *inter alia* includes a section on "Policy charges" whereby provision is made for the following (additional) policy charges to be recovered: marketing and administration charge of 9,64%; policy fee of R00; yearly service fee of 0,5%, yearly fund management fee depending on a portfolio invested; statutory charges, including tax and stockbroker fees; performance fee for the asset manager.

[24] It is only those charges that are provided for in either the rules or the policy document that the insurer and/or the fund may deduct from a member's investment value. Rule 2 of Part 7 of the rules provides for the conversion of a policy to a "paid-up policy for reduced benefits" if a member's contributions cease before the contractual retirement date There is, however, no definition of the phrase "paid-up policy for reduced benefits", and most definitely, no provision for the charging of a premium termination fee. However, as already indicated, a premium termination fee is provided for in the policy document, but the amount thereof is restricted to what is stated expressly and unambiguously in that document.

[25] Not only must the board of a fund act strictly in accordance with the provisions of the rules of the fund, the applicable legislation and the common law, but they are also 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.

[26] As Davis J stated in *Central Retirement Annuity Fund v Pension Funds Adjudicator and Others* [2005] 8 BPLR 655 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] For the above reasons, I am satisfied that the fund was not entitled to permit the above reduction to your benefit other than to the extent authorized by the rules and the policy document.

[28] In the result, the order of this Tribunal must be a reversal of the "premium termination fee", but only to the extent that it exceeds the foreign currency equivalent of R200. Since it is the insurer that levied this fee, it is against it in its capacity as administrator that such an order must be made.

[28.1] It is hereby declared that the respondents had no right in law to levy the charge of R38 807 as an "premium termination fee" on the complainant's investment value solely by reason of his having ceased contributing to the fund prior to his selected retirement date.

[28.2] Sanlam Life Insurance Limited ("the insurer"), in its capacity as the administrator of the fund, is ordered forthwith to re-calculate your fund value as if the amount of R38 807 had not been deducted when you reduced the contributions to the fund with effect from 1 February 2005, and to inform you of this value within 3 weeks of the date of this determination.

SIGNED IN CAPE TOWN ON THIS DAY OF 2006

Yours faithfully

Vuyani Ngalwana
PENSION FUNDS ADJUDICATOR