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Dear Sir,

**DETERMINATION IN TERMS OF SECTION 30M OF THE PENSION FUNDS ACT,
24 of 1956 ("the Act"): J M SMITH ("complainant") v PROFESSIONAL
PROVIDENT SOCIETY RETIREMENT ANNUITY FUND ("first respondent") AND
SANLAM LIFE INSURANCE LIMITED ("second respondent")**

[1] INTRODUCTION

- 1.1 The complaint concerns the advice provided by the complainant's broker regarding his retirement annuity policies, the poor investment return on his policies and the quantum of the causal event charge upon requesting transfer of the policies prior to the maturity date.

- 1.2 The complaint was received by this tribunal on 5 August 2011. A letter acknowledging receipt thereof was sent to the complainant on 25 August 2011. On 24 August 2011 a letter was dispatched to the respondents giving them until 30 September 2011 to file a response. A response from the respondents, which was forwarded to the complainant, was received on 9 September 2011. On

The Office of the Pension Funds Adjudicator was established in terms of Section 30B of the Pension Funds Act, 24 of 1956. The service offered by the Pension Funds Adjudicator is free to members of the public.

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12 September 2011 this tribunal received further submissions from the complainant.

1.3 Having considered the written submissions it is considered unnecessary to hold a hearing in this matter. As the background facts are known to the parties only those facts that are pertinent to the issues raised herein will be repeated. The determination and reasons therefor appear below.

[2] FACTUAL BACKGROUND

- 2.1 The complainant applied for and was admitted to the membership of the first respondent. He has five retirement annuity fund policies with the first respondent, which commenced on different dates and with different contractual retirement dates. The policies are underwritten by the second respondent.
- 2.2 On 30 August 2011 the complainant terminated the policies and requested a transfer to another approved retirement annuity fund. The complainant was provided with a table which reflects his policy values including causal event charges in respect of the terminated policies. His fund values and the charges were as follows:

Policy No	Fund Value (R)	Charge (R)	Percentage
18861739x3	100 997.87	23 244.87	23.02 %
18861762x5	66 548.00	18 217.44	27.37%
18861785x6	99 028.57	29 708.58	30.00%
18861792x2	100 002.41	30 000.69	30.00%
041965376x1	60 770.85	14 919.24	24.55%

[3] COMPLAINT

- 3.1 The complainant submits that Greenacres Brokers failed to advise him on various issues, which includes the fact that there would be charges

upon termination of the policies prior to the maturity date. It also did not provide him with information regarding the second respondent's projected annual growth rates per policy, historical performance, alternative investment vehicles and that their fees would be paid upfront.

- 3.2 The complainant states that the second respondent failed to explain the low growth achieved on his policies. He contends that according to his calculations the second respondent's portfolios achieved a growth of between 0.48% to 7.26% *per annum*, the average being 4,54% *per annum*, until 4 March 2011. Its projected growth rate on average varies between 3.76% to 8.57% based on compound interest. He referred to policy 041965376x1, which was supposed to achieve a growth rate of 8% higher than inflation. However, the policy only achieved a growth rate of 3.44% *per annum*.
- 3.3 The complainant states that Allan Gray, on the other hand, achieved a growth rate of 17.10% during 2010, it averaged 15% *per annum* during the last five years and averaged 23% *per annum* during the last 10 years. The growth excludes broker's fees. In addition to the poor performance of the policies the respondents also want to deduct causal event charges of R119 000.00, which is equivalent to 30% of the fund values.
- 3.4 In conclusion, the complainant submits that he suffered financial loss as a result of the failure of the second respondent to achieve a growth rate that is above inflation. Further, he avers that he should be allowed to transfer his policies without any causal event charges.

[4] **RESPONSES**

First respondent's response

- 4.1 The first respondent states that it operates exclusively by way of individual policies that it takes out in respect of its members. It contends that it does not have investment funds or investment accounts for its members. Its rules also do not make provision for investment funds. In terms of its rules the member chooses the type of policy including the investment portfolio and other features of the policy. The first respondent is the owner of all policies, in terms of the rules.
- 4.2 The complaint is about the execution of duties by the second respondent as an insurer, which constitutes long-term insurance business in terms of the Long-Term Insurance Act, 52 1998 ("Long-Term Insurance Act"). Such a grievance does not constitute a "complaint" as defined in the Act as it does not relate to the administration of the fund.
- 4.3 Further, the complainant's policies will have to be surrendered in event of a transfer to another fund. The surrendering of the policies in this circumstance constitutes a causal event. This causal event will affect the fund's liability to the complainant as provided in rule 22.9. Thus, a causal event charge will have to be deducted in order to cover for the loss.

Second respondent's response

- 4.4 The second respondent also submits that the complainant's policies are part of its long-term insurance business and as result are regulated by the Long-Term Insurance Act.
- 4.5 As regards the investment return on the policies, the second respondent does not guarantee a return that is above inflation on these policies. However, it acknowledges that it uses inflation as a reference

tool to compare investment returns. The complainant's policies are market-related and therefore the actual returns depend on market movements over the duration of each policy. All inflation assumptions are based on the Consumer Price Index (CPI) as published by Statistics South Africa. It provided a table which reflects a summary of the inflation rate since the inception of the complainant's policies. It reads as follows:

Year	CPI
2004	3.30%
2005	3.60%
2006	5.80%
2007	9.00%
2008	9.50%
2009	6.30%
2010	350%
2011	3.60%
Average	6.07%

- 4.6 The table shows that average inflation over the period was closer to 6% than the 8%-10% that the complainant stated in his complaint. The complainant's calculation does not take into account charges such as annual policy fees and administration charges that were recovered from the policies. Depending on the policy, these charges can reduce the overall returns from anything between 0.90% to 1.60% *per annum*.
- 4.7 The complainant's calculation also does not take into account the time value of money, i.e. the fact that monthly premiums are paid at different points in time. The complainant simply added all premiums together in his calculation and arrived at a conclusion. A correct calculation looks at each monthly premium over time and solves for an internal rate of return that gives the fund value. If computed in this way the rate of return on the four policies would be as follows:

Policy number	Fund value	Annual return to date	
		Sanlam	P/h
18x61739xx	93,742.37	9.39%	5.73%
18x61762xx	68,345.10	0.94%	0.48%
18x61785xx	94,134.96	9.50%	5.81%
18x61792xx	101,154.40	11.42%	7.26%
Total	357,376.83	8.11%	4.82%

- 4.8 The second respondent states that the total returns on the four policies show a real return that is above inflation. Policy 18x61762xx shows a negative return, but this is due to the underlying investments that the complainant selected, which were volatile and had annual bonus rates as low as -23% and as high as +32% depending on the individual year.
- 4.9 Causal event charges had to be deducted from the complainant's policies as payment of the premiums will be stopped on transfer to another fund. The termination charges ensure that all the expenses already incurred on the policies are recovered. Expenses are incurred when a policy is issued and these expenses are recovered by means of policy charges over the term of the policy. The policy charges are determined by assuming that premiums will be paid as agreed in the contract. In the event that a policy is terminated earlier all the expenses already incurred will not be recovered as no future policy charges will be received. The causal event charges are within the parameters set out in the regulations of the Long-Term Insurance Act.
- 4.10 As regards the conduct of Greenacres Brokers, the second respondent states that they are independent brokers. It does not have jurisdiction over them and as such it is not vicariously liable for any acts or omissions on their part. The complainant should refer this aspect of the complaint to FAIS Ombudsman.

[5] **DETERMINATION AND REASONS THEREFOR**

Jurisdiction

- 5.1 The respondents submit that the complainant's policies form part of long-term insurance business in terms of the Long-Term Insurance Act. Therefore, they contend that a complaint relating to the policies is not a "complaint" as defined in the Act as it does not relate to the administration of the fund.
- 5.2 The respondents are referred to two judgments of the High Court of South Africa, *viz. Central Retirement Annuity Fund v Adjudicator of Pension Funds and Others* [2005] 8 BPLR 655(C) at 660C-E and *Old Mutual Life Assurance Company (SA) Limited v Pension Funds Adjudicator and Others* [2007] 1 BPLR 117 (C) at 124B-C, as well as the recent judgment of the Supreme Court of Appeal in *Mungal v Old Mutual Life Assurance Co SA Ltd; Freeman v Old Mutual Life Assurance Co SA Ltd* [2010] 1 BPLR 11 (SCA). These court rulings confirm this tribunal's jurisdiction to adjudicate complaints concerning retirement annuity funds. Therefore, the technical point is dismissed.
- 5.3 The complainant's claim regarding the conduct of Greenacres Brokers is not a "complaint" as defined in section 1 of the Act. This is due to the fact that it concerns the broker's conduct and does not relate to the administration of the fund, the investment of its assets or the interpretation or application of its rules. The complainant should refer this aspect of the complaint to the Office of the Ombud for Financial Services ("the FAIS Ombud") whose contact details appear below.

The merits

Investment returns

- 5.4 The complainant was not given any guarantees regarding the investment return on his policies. He was provided with illustrative values at the commencement of his policies, which were dependent on certain underlying assumptions. The facts indicate that the second respondent's inflation assumptions are based on CPI. The average inflation for the duration of the policies was closer to 6% and not 8% - 10% as stated by the complainant. The complainant's policies and his chosen portfolios are market-related and therefore the actual returns depend on market conditions.
- 5.5 The respondents have explained the investment performance of the complainant's policies in detail by providing tables which show his fund values and the investment returns allocated to his policies. The complainant provided a calculation of his fund values which is not in accordance with the manner in which the investment took place. His computation did not take into account annual policy fees and administrative expenses that were deducted from the policies. These charges reduced the overall annual returns of the policies.
- 5.6 This tribunal engaged the services of an independent actuary, who evaluated the information and concluded that the investment returns are correct and should not be confused with the illustrative fund values. The comparison that the complainant made between the returns achieved by Allan Gray and his policies is not justifiable as the underlying investment portfolios may not be the same.

Causal event charges

- 5.7 The complainant's policies were also negatively affected by the fact that causal event charges had to be deducted, as he requested a transfer of his policy values to another fund. This resulted in the surrender of the policies prior to their contractual maturity dates. In terms of the regulations and the rules the surrender of the policies in this circumstance amounts to a causal event. The second respondent had to recover the expenses it had incurred when the policies were issued. This is authorised in terms of the regulations and the policy contract. The complainant cannot prematurely surrender the policies and transfer to another fund without incurring these charges.
- 5.8 The basis for imposing causal event charges needs to be determined and it must be decided whether or not the causal event charge levied by the second respondent was fair and reasonable. In this regard Fourie J, in *Old Mutual Life Assurance Company (SA) Ltd v Pension Funds Adjudicator and Others* [2007] 1 BPLR 117 (C) at paragraph 35, noted that:
- "The fact that the policy does not specify a formula according to which the paid-up reduced benefit is to be calculated, does not mean that Applicant has an unfettered discretion to arbitrarily determine a value in a manner that is unfair, unreasonable or capricious. In this regard, I am in agreement with Applicant's submission that the provisions of the LTIA, referred to hereunder, dictate that the paid-up reduced benefit to which Second Respondent is entitled has to be calculated in accordance with generally accepted actuarial principles and practice."
- 5.9 The learned judge having confirmed that causal event charges may be imposed by underwriting insurers, what remains is to ascertain the fairness and reasonableness of the causal event charge levied by the second respondent. This tribunal takes cognisance, firstly, of the provisions of section 46 of the Long-Term Insurance Act, which reads as follows:

"A long-term insurer shall not-

- (a) enter into any particular kind of long-term policy unless the statutory actuary is satisfied that the premiums, benefits and other values thereof are actuarially sound;
 - (b) make a distinction between the premiums, benefits or other values of different long-term policies unless the statutory actuary is satisfied that the distinction is actuarially justified; or
 - (c) award a bonus or similar benefit to a policy-holder unless the statutory actuary is satisfied that it is actuarially sound and that a surplus is available for that purpose.”
- 5.10 Section 52 of the Long-Term Insurance Act prescribes the manner in which long-term policies are to be dealt with in the event of premature cessation of contributions. The insurer must have rules approved by the statutory actuary that prescribe a sound actuarial basis and the method to be used to value a long-term policy in the event of a causal event occurring. Thus, the benefits and values attaching to a prematurely terminated policy, and any distinctions between it and policies that do not prematurely terminate, must be actuarially sound.
- 5.11 In addition to the requirement that causal event charges must be computed using generally accepted actuarial principles that ensure the actuarial soundness of the insurer, on 1 December 2006 the Minister of Finance promulgated regulations in terms of the Long-Term Insurance Act that stipulate maximum causal event charges in respect of causal events that occurred on or after 1 January 2001.
- 5.12 This tribunal engaged the services of an independent actuary, who reviewed the causal event charges imposed on the complainant’s policies and he found that they are fair and reasonable. They are also in line with the regulations and within the maximum limit of 30%. This tribunal accepts that the charges were in line with the regulations and were therefore reasonable as confirmed by the actuary.

5.13 After careful consideration of the facts placed before this tribunal it is evident that the second respondent acted in accordance with generally accepted actuarial practice, the provisions of the rules, the provisions of the policy documents, the provisions of the Long-Term Insurance Act and the regulations. This tribunal accordingly finds that the causal event charges that were imposed by the second respondent were not unfair, unreasonable or capricious in nature.

[6] ORDER

1. In the result, the complaint cannot be upheld and is dismissed.

DATED AT JOHANNESBURG ON THIS 15TH DAY OF MARCH 2012

**DR EM DE LA REY
ACTING PENSION FUNDS ADJUDICATOR**

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Section 30M Filing: Magistrate Court

Parties unrepresented