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Dear Sirs and Madams,

DETERMINATION IN TERMS OF SECTION 30M OF THE PENSION FUNDS ACT, 24 OF 1956 (“the Act”): RP SENAMOLELA AND 5 OTHERS (“complainants”) v MAFIKENG CITY COUNCIL PENSION FUND (“first respondent”); LIBERTY GROUP LIMITED (“second respondent”) AND MAFIKENG CITY COUNCIL (“third respondent”)

[1] INTRODUCTION

- 1.1 This complaint concerns the alleged maladministration of the first respondent, a defined benefit fund, which has resulted in it being underfunded and unable to comply with its statutory obligations regarding payment of benefits.
- 1.2 The complaints were received by this Tribunal on 2 April 2014. On different dates during April 2014, acknowledgement letters were sent to the complainants. On the same dates that the acknowledgement letters were sent, copies of the complaints were forwarded to the respondents requesting them to file their responses by during May 2014. On 22 April

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.

Centralised Complaints Helpline for All Financial Ombud Schemes 0860 OMBUDS (086 066 2837)

2014, a response was received from the second respondent responding to all complaints. On 12 May 2014, a follow up letter was sent to the third respondent requesting it to submit its response by 26 May 2014. On 12 May 2014, the second respondent's response was forwarded to the complainants requesting them to reply thereto by 26 May 2014. On 20 June 2014, a follow up letter was sent to the first respondent requesting it to submit its response by 6 July 2014. No further submissions were received from the parties.

- 1.3 Having considered the written submissions before this Tribunal, it is considered unnecessary to hold a hearing in this matter. As the background facts are known to all 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 complainants are employees of the third respondent and commenced their employment on different dates. By virtue of their employment with the third respondent, the complainants were registered with the first respondent. The second respondent is the administrator of the first respondent. The complainants appear in annexure "A" of this determination. Each complainant submitted a separate complaint. However, due to the fact that the issues are the same, the complaints shall be jointly addressed.

[3] COMPLAINT

- 3.1 The complainants submit that before 1994 the first respondent was administered by Old Mutual (SA) Limited and was properly administered. They submit that during this period of administration, they

even earned demutualisation shares. They submit that after 1994, the first respondent changed administrators to the second respondent without informing them. They submit that during 2001, in one of the union meetings, they were informed that the first respondent was in deficit of about R94 million and they were assured that the third respondent would address the deficit. The complainants submit that this problem has since worsened.

- 3.2 The complainants submit that they are concerned that due to the fund not being in a sound financial position, they will not have sufficient funds for their retirement, death or disability. They submit that due to the poor administration of the first respondent, there are no proper or guaranteed investments. They submit that they are also uncertain as to what happened to the demutualisation shares which had accrued to them and they were allocated certificates. They submit that to date, they are not aware of the response of the third respondent to the letter of December 2013 by the second respondent. They submit that they fear that an adverse decision may be taken by the third respondent as its senior management is not part of the first respondent as it is employed on contract basis.
- 3.3 The complainants request this Tribunal to investigate and order an audit of the first respondent to determine how the deficit came about from 2000 to date. They submit that they would like to establish where their monthly contributions are invested and the reasons for the poor performances of the first respondent. The complainants want to be provided with information regarding their guaranteed payouts. They also want to know the third respondent's response to the issues raised in the second respondent's letter.

[4] RESPONSES

First respondent

- 4.1 The first respondent was afforded the opportunity to comment on the allegations made against it as required in terms of section 30F of the Act. It failed or neglected to respond. In the circumstances, this Tribunal has no alternative but to dispose of the matter on the basis of the available facts.

Second respondent

- 4.2 The second respondent submits that the first respondent is a defined benefit fund. It admits that the first respondent has a substantial deficit and that if it not addressed, it will struggle to pay its members their benefits when they become due. It submits that currently, the first respondent is still able to pay benefits when they become due. It submits that the reasons for the deficit appear in its letter dated 3 April 2014 addressed to the chairman of the first respondent, which is attached. It submits that it has also reported the first respondent to the Financial Services Board (“the FSB”) which called on the first respondent to produce a plan in terms of section 18 of the Act on how the board of the first respondent proposes to address the deficit. It submits that to date no response was provided by the first and third respondents regarding the deficit. It submits that on 18 April 2014, it was informed by the FSB that it has taken the issue of the deficit with the first respondent.
- 4.3 The second respondent submits that the complainants do not indicate the basis of why they allege that the first respondent is being incorrectly administered. It submits that if the allegation stems from the deficit, it refers to its letter to the board and its recommendations therein. The second respondent denies that it has poorly administered the first respondent. It submits that the allegation that the first respondent is being poorly administered is incorrect as the first respondent is a defined benefit fund and its benefits are guaranteed by its rules rather

than by the underlying investment portfolio. Further, the board of the first respondent determines its investment strategy.

4.4 The second respondent submits that when Old Mutual demutualised at the beginning of 1999, it awarded shares to all its qualifying members who held policies at midnight on 25 September 1998. It submits that as part of this process, the first respondent was awarded some shares. It submits that its records show that a total of 548 113 shares were awarded to the first respondent. It submits that the board at the time decided to allocate these shares to members of the first respondent whilst the dividends from these share would accrue to the first respondent. It submits that as part of this decision, members who were allocated shares were provided with share certificates reflecting their share allocation. It submits that these shares are under the board's control, which from time to time, authorises payment to the members in terms of the first respondent's rules. The second respondent submits that it assists with the payment at the request of the board.

4.5 The second respondent responded as follows to the relief sought by the complainants:

- Regarding the request for an audit of the first respondent; it submits that its annexure "A" discusses the cause of the deficit. It submits that now that the FSB is involved, it is likely to look at these causes too.
- Regarding where the current contributions are going; it submits a letter to the chairman of the board confirming that the current contributions are invested in terms of the current investment strategy which was approved by the board in July 2013.
- Regarding the submission that the second respondent be investigated for enriching itself and failing to give the members their just dues; it submits that the board of the first respondent choses the portfolios in which the assets of the first respondent should be invested. It submits that as indicated in annexure E, before changes to investment strategy in July 2013, of the six portfolios in which the assets of the first respondent were invested, only one was the second respondent's portfolio and the

remainder were invested in Old Mutual and Investec portfolios. It submits that in terms of the new strategy, the first respondent's assets are invested in the Stanlib, Liberty, Coronation and Old Mutual portfolios. It submits that like other asset managers, it only charges investment fees as agreed with the board. It denies any wrongdoing and commits to submit itself to any enquiry, if instituted.

- Regarding the submission that the complainants believe that whereas they should be earning interest on their funds and instead they are in deficit; it submits that even though the statement is not very clear, its response regarding poor investments appears on annexure "A" of its submissions and that it can be seen that following the implementation of the new investment strategy in July 2013, there has been an improvement in the investment returns.
- Regarding the demand for transparency and guaranteed pay-outs by the complainants; it submits that it conducts its business and deals with its customers in a transparent manner and in compliance with treating customers fairly ("TCF") principles and will continue to do so.
- It submits that the first respondent is a defined benefit fund. It submits that as a result the benefits payable by the fund are defined in terms of its rules, calculated in terms of a formula which takes into account the years of service and the average salary of the member a few years before retirement. It submits that for as long as the formula is not amended in the rules, this will be used to calculate the member's benefits. It submits that if for some reason, the assets in the fund are insufficient to pay benefits calculated in terms of this formula, the employer is required in terms of the rules and the Act to add into the fund as much money as may be required to pay benefits that are due.

Third respondent

- 4.6 The third respondent was afforded the opportunity to comment on the allegations, made against it as required in terms of section 30F of the Act. It failed or neglected to respond. In the circumstances, this

Tribunal has no alternative but to dispose of the matter on the basis of the available facts.

[5] **DETERMINATION AND REASONS THEREFOR**

Introduction

5.1 The issues for determination are; firstly, whether or not the first respondent is being maladministered by the second respondent and secondly, whether as a result of the maladministration by the second respondent the first respondent is in a financial deficit and lastly, if the first respondent is in deficit, whether the first respondent will be able to pay its members their benefits in full upon disability, death or withdrawal.

A fund is governed in terms of its rules

5.2 The fund or its board can only do what is set forth in the registered rules (see section 13 of the Act and *Tek Corporation Provident Fund and Others v Lorentz* [2000] 3 BPLR 227 (SCA) at 239D-F and *Mostert NO v Old Mutual Life Assurance Company (SA) Ltd* [2001] 8 BPLR 2307 (SCA) at paragraph 30). Section 13 of the Act, reads as follows:

“Subject to the provisions of this Act, the rules of a registered fund shall be binding on the fund and the members, shareholders and officers thereof, and on any person who claims under the rules or whose claim is derived from a person so claiming.”

The alleged maladministration of first respondent

5.3 It is common cause that the first respondent has a substantial deficit. According to the letter from the second respondent to the first respondent dated 17 December 2013, the deficit as at 1 July 2013

stood at R166 612 455.00 and a funding level of 52.75% of the estimated liabilities of the first respondent. What appears to be in dispute is the cause of the deficit. The complainants submit that the deficit in the first respondent coincided with the second respondent's takeover of the first respondent's administration. Although not explicitly stated, it is implied that the second respondent is the cause of the deficit in the first respondent. The second respondent denies that it is responsible for the deficit, it submits instead that it pointed out the reasons for the deficit in its letter of 3 April 2014 to the chairman of the first respondent's board where it submitted that:

"In the forthcoming paragraphs we have analysed the factors that have caused or worsened of the deficit position of the Fund from R14 million as at 1 July 2006 to R166 million as at 1 July 2013. These factors are as follows:

a) Deficit brought forward

The deficit as at 1 July 2006 amounted to R14.591 million. This deficit amount, updated with the expected rate of return over the period from 1 July 2006 to 1 July 2013 amounted to a strain of approximately R27 million as at the valuation date.

b) Inappropriate investment strategy

The discount rate used for the purposes of the actuarial valuation is based on the expected return on notional assets which would be a suitable match for the nature of the liabilities of the Fund.

The liabilities of the Fund are related to salary and price inflation. Real asset classes such as equities and property are therefore required to ensure a real long-term rate of return in relation to salary increases granted to active members and in relation to pension increases granted to pensioners. These investments protect the erosion of the financial position of the Fund due to inflation. Foreign assets provide diversification and extra returns if the Rand

depreciates. The other sectors can be expected to provide reasonable and secure returns in the short term.

An appropriate investment strategy would therefore be one that has a high exposure to real asset classes such as property and equities whose growth would be expected to match the increase in salaries. The Fund's investment strategy was inappropriate due to the following:

- Approximately half of the assets of the Fund were invested in cash, which as an asset class, is a poor match for salary inflation.
- The other half of the assets was invested in a guaranteed portfolio, which was overly conservative given the nature of the liabilities of the Fund.

The inappropriate strategy resulted in the actual investment returns being lower than expected based on the assumptions used for purposes of the valuation, resulting in a strain to the Fund of approximately R23 million.

The issues regarding the investment strategy were discussed at the previous board meetings and a revised strategy was adopted on the 17th of July 2013 and has since been implemented (see attached document).

c) Salary increases higher than expected

The benefits payable from the Fund on exit are dependent, *inter alia*, on the rates of salaries as this is a defined benefit fund. As part of the actuarial valuation process, an estimation is made about the benefits that will be payable in future and this requires an estimation of future salaries on which these benefits will be based.

For purposes of the actuarial valuation, an assumption is therefore made about the salary increases that are expected to be granted by the municipality in future years up to retirement. If the actual increase granted by the municipality

turns out to be higher than assumed for purposes of the actuarial valuation, this will result in a strain on the Fund.

The actual salary increases that were granted to the employees were higher than assumed for our valuation purposes resulting in a strain to the Fund, of approximately R81 million.

d) Employer contributions lower than expected

The employer future service contribution rate, expressed as a percentage of total pensionable salaries, is the rate required to fund the future benefits being earned by the members, over a specified future period. The future service contribution rates are derived using assumed investment returns, future salary and pension increases, and anticipated deaths.

The contribution rate needed for the risk benefits should be equal to the annual insurer's premium payable, expressed as a percentage of total pensionable salaries, as the risk benefits are insured.

The employer contributions towards funding the future benefits accrual and the risk premiums were lower than those required based on the actuarial valuation assumptions. This resulted in a strain to the Fund of approximately R19 million.

e) Miscellaneous factors

There are various other sources of surplus and strain that, together with differences caused by some of the methods of approximation used in calculating the above sources, constitute the balancing strain item of approximately R16 million. These items have not been quantified separately."

5.4 In its submissions, not only does the second respondent deny that it is the cause of the deficit; it also submits that the deficit was in existence

when it took over the administration of the first respondent. It submits that among others, the deficit has grown due to an inappropriate investment strategy of the first respondent's board, the salary increases of the members that were higher than expected actuarial assumptions and the employer contributions that were less than the actual contributions required. The second respondent submits that it has reported the issue of the deficit to the FSB as it is required to and it has indicated the necessary recommendations that would bring the first respondent to normality or alternatively to convert it from a defined benefit to a defined contribution fund. The second respondent submitted that the FSB is involved and has requested for a scheme in terms of section 18 of the Act and has requested for submissions in terms of section 15(3) of the Act as appears on the FSB letter to the second respondent of 31 January 2014. On the evidence submitted, this Tribunal is not convinced that the second respondent is the cause of the deficit as submitted by the complainants.

The effects of the deficit in the first respondent

- 5.5 Despite the fact that the second respondent may not be the cause of the deficit, the existence of the deficit and the concerns of the complainants flowing therefrom still need to be addressed. Section 18 of the Act provides for instances where a pension scheme is not in a sound financial position and is unable to meet the financial needs of its members in terms of the Act and provides as follows:

“Fund not in a sound financial condition

- (1) When any return under this Act indicates, in the opinion of the registrar, that a registered fund is not in a sound financial condition, the registrar shall, save as provided in section twenty-nine, direct the fund to submit a scheme setting out the arrangements which have

been made or which it is intended to make to bring the fund into a financially sound condition within a reasonable period, and the fund shall deposit such scheme with the registrar within three months from the date of receipt of the said direction, together with a report thereon by a valuator or, in the case of a fund to which the provisions of section seventeen apply, by the auditor of the fund.

- (1A) When any return under this Act indicates a deficiency in a registered fund, the fund shall, within three months from the date of such return, submit a scheme to the registrar setting out the arrangements which have been made or which it is intended to make to eliminate the deficiency, together with a report thereon by a valuator.
- (2) If a registrar finds that a scheme submitted in terms of subsection (1) or (1A) is not inconsistent with the provisions of this Act and is satisfied that the arrangements set out therein should suffice to accomplish the objects of this section, he shall approve the scheme...”

5.6 This Tribunal takes note of the fact that due to the existence of the deficit, the Registrar has requested the first and third respondents to submit a scheme in terms of section 18 of the Act. The Registrar is empowered in terms of section 18(5)(a) to order an audit of the fund where he is not satisfied the scheme provided by a fund will not address the lack of financial soundness of the fund. Notwithstanding, this Tribunal has jurisdiction to investigate and issue a determination regarding the financial affairs of the first respondent, as it is a complaint as defined by the Act. However, the relief sought, to decide on the appropriate remedy of getting the first respondent into financial normality, including the decision whether an auditor should be appointed in terms of section 18 of the Act lies within the power of the Registrar as the appropriate functionary to conduct the processes stipulated therein (see *Simelane And Others NNO v Seven-Eleven Corporation Sa (Pty) Ltd And Another* 2003 (3) SA 64 (SCA) at paragraphs 12 -14).

5.7 The complainants are concerned about whether the first respondent will be able to honour its obligations in terms of payment of benefits. The second respondent correctly submitted in this respect that, the first respondent is a defined benefit fund and its benefits are paid in terms of fixed formula as contained in its rules. It submits that if for some reason, there are insufficient funds to fulfill these obligations; the third respondent is legally obliged to pay whatever funds are needed to address the deficit or may amend the formula to pay lesser benefits. As a result, this Tribunal finds that deciding on these issues will be preempting the process currently being undertaken by the Registrar in terms of section 18. For these reason, a copy of this determination will be forwarded to the Registrar for her consideration.

The ruling

5.8 In the event, this Tribunal finds that the complaint against the second respondent for maladministration of the first respondent is dismissed. This Tribunal makes no finding regarding the deficit in the first respondent as the matter is subject to a process in terms of section 18 of the Act. Without wishing to encroach on the Registrar's turf, this Tribunal is disturbed by the behavior of the board of first respondent's failures in carrying out its statutory duties, in that, not only did it fail to respond to the allegations raised against it before this Tribunal, but it displayed complete disregard towards its members by failing to inform them of the *status quo* in the first respondent in terms of section 7D(c) of the Act. The failure by the first respondent to provide its members with clear and appropriate information also contravenes outcome three of the TCF principles. Outcome 3 of the TCF principles states that customers should be given clear information and kept appropriately informed before, during and after the time of contracting.

1. In the result, the complaint cannot succeed and is dismissed.

DATED AT PRETORIA ON THIS 22ND DAY OF JULY 2014

MA LUKHAIMANE
PENSION FUNDS ADJUDICATOR

Section 30M filing: High Court

Parties were not represented

ANNEXURE "A"

NAME	PFA REFERENCE NUMBER	ADDRESS
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Inno GM	NW/00007879	P O Box 5926

		Mmabatho 2735
Medupe MM	NW/00007880	Private Bag X 59 Mmabatho 2735
Thebe KA	NW/00007883	5151 Unit B Mmabatho 2735
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