

IN THE TRIBUNAL OF THE PENSION FUNDS ADJUDICATOR

CASE NO: PFA/KZN/14/98/NJ

In the complaint between:

WILLIAM BARRIE HORLOCK

Complainant

and

ILLOVO SUGAR PENSION FUND

First Respondent

C G SMITH SUGAR RETIREMENT BENEFIT FUND

Second Respondent

**DETERMINATION IN TERMS OF SECTION 30M OF THE PENSION FUNDS ACT OF
1956**

Introduction

This is a complaint lodged with the Pension Funds Adjudicator in terms of section 30A(3) of the Pension Funds Act of 1956. The complaint concerns the exclusion of the complainant in the distribution of a surplus within a fund.

No hearing was held in this matter. Accordingly, I have relied exclusively on documentary evidence, arguments put to me in writing and a report placed before me by my investigator, Naleen Jeram.

The complainant is Barrie Horlock, a retired male, a former member of the first and second respondent, of Kloof, KwaZulu Natal.

The first respondent is Illovo Sugar Pension Fund (hereinafter referred to as “the fund”), a defined benefit pension fund duly registered under the Pension Funds Act of 1956.

The second respondent is C G Smith Sugar Retirement Benefit Fund (hereinafter referred to as “the provident fund”), a pension fund duly registered under the Pension Funds Act of 1956. Both respondents are represented by Mrs Meijer of Garlicke & Bousfield Inc attorneys.

The complainant commenced employment with the Illovo Sugar (Pty) Ltd on 1 August 1974 at which point he also became a member of the fund, a defined benefit fund. Shortly after joining the employer the complainant was appointed as a trustee of the pension fund and remained so until his early retirement on 28 February 1995. At that point the employer requested him to remain on as a trustee, which he duly did until he voluntarily resigned as a trustee on 19 August 1997.

Complaint

This complaint relates to the administration of the respondents and alleges that there has been maladministration of the funds as a result of which the complainant has sustained prejudice.

The provident fund was established during 1993. This was also a defined benefit fund. The purpose behind the creation of a provident fund was to provide the executives of the employer participating in the fund greater flexibility in relation to these defined benefits. It appears as if the biggest advantage was that the member of the provident fund could receive his entire benefit as a lump sum as opposed to a pension or annuity. All eligible members (including the complainant) of the pension fund were sent a letter outlining the advantages and disadvantages of moving into the provident fund and if they had any problems they were asked to contact the complainant who was also a trustee of the provident fund. The complainant initially elected to remain with the pension fund.

The relevant rule allowing transfers to the provident fund read as follows:

The following special provisions shall apply with effect from 1 February 1994:-

Those members in service on 31 January 1994 who on 1 February 1994 are eligible for membership of the CG Smith Sugar Retirement Benefit Fund (the "Retirement Benefit Fund") shall have the option either to become members of that fund on that date or to remain members of the fund. Such option shall be exercisable by notice in writing given to the Trustees. If no notice of election to become a member of the retirement benefit fund is given to the trustees by any member by 31 January 1994 the member shall remain a member of the fund.

A member who elects to become a member of the retirement benefit fund

- (1) shall cease to be a member of the fund on joining the retirement benefit fund;
- (2) shall as from the date of cessation of membership be entitled to a lump sum benefit equal to his accumulated contributions at the date of his cessation of membership. Such benefit shall be required to be transferred, after payment of any income tax payable thereon, to the retirement benefit fund, to be applied under that fund in terms of the rules of that fund.

In the case of each member to whom (b) applies, there shall also be transferred to the retirement benefit fund an amount equal to the difference (if any) between his actuarial reserve as determined by the actuary at the date of cessation of membership and the amount referred to in (b) before payment of any income tax payable thereon, to be applied under the retirement benefit fund in terms of the rules of that fund.

Eighteen executive members of the pension fund elected to transfer from the pension fund to the provident fund at more or less the same time in 1994 and a single actuarial calculation of the value of the pension fund was performed in respect of all of the transferring members. The transferring members' combined actuarial reserve values amounted to R15,211,000.00. A full pro rata share of the assets of the pension fund in respect of the transferring members amounted to R5,172,000.00. In addition, the actuary of the pension fund recommended that an additional sum of R4,700,00.00 be transferred to the provident fund. In total, the sum of R25,083,000.00 was transferred from the pension fund to the provident fund, being the actuarial reserve enhanced by an additional 39.4%.

In about December 1994 the complainant had a change of heart and elected to transfer to the provident fund. In an internal memorandum addressed to Mr G Taylor, chairman of trustees of both funds, he requested to transfer to the provident fund with effect from 31 January 1995. The rules of the pension fund did not allow for such a transfer. Mrs Meijer, explains how the transfer took place:

Although the Complainant was not among the initial 18 members of the first respondent (pension fund) who elected to transfer to the second respondent (provident fund), one of the 18 members transferred back to the first respondent (pension fund). When the complainant made his decision to transfer to the second respondent (provident fund), the actuary recommended that the complainant be substituted for that member as the difference between the two member's actuarial reserve values was not significant. At the time of the complainant's decision to transfer it was agreed by the complainant, the first respondent (pension fund) and the second respondent (provident fund) that the complainant's membership of the second respondent (provident fund) would be deemed to be effective from 1 March 1994 and the necessary adjustments were made between the first respondent (pension fund) and the second respondent (provident fund).

One month after transfer, on 28 February 1995, the complainant elected to take early retirement. The relevant rule applicable to him reads:

Early retirement

Subject to the consent of his employer a member who has completed at least 5 years' qualifying service may retire at any time during the ten-year period ending on his normal retirement date and shall thereupon become entitled to a lump sum benefit calculated in accordance with the provisions of Rule 5.1; provided that for the purposes of determining his benefit the benefit described in Rule 5.1 before the application of the cash conversion factor shall be reduced by,

- (3) one-twelfth of 2 per cent for each completed month up to 36 months by which the date of his retirement precedes normal retirement date;
- (4) one-twelfth of 4.5 per cent for each complete month in excess of 36 months by which the date of his retirement precedes normal retirement date.

The benefit was computed as follows:

<u>Provident Fund Benefit</u> (before tax)		
$2\% \times 23 \frac{1}{12} \times R318,000 \times 0,7863 \times 14,283$	=	R1,648,782
Plus		
$3 \times R360,000 \times 0,7863 \times 0,1958$	=	<u>R 166,274</u>
Total Lump Sum		<u>R1,815,056</u>

After a tax deduction the complainant received a lump sum of R233,912.57 and an amount of R1,506,402,43 which he invested with Investec for the purchase of a link life annuity. On receipt of his full lump sum benefit the complainant relinquished his membership of the provident fund. However, at the request of the employer the complainant remained on as a trustee of both the pension and provident fund.

Two and a half years later in 1997 the trustees of both funds decided to create a defined contribution section within their respective funds. The surplus that had built up within the funds was to be distributed as follows:

Active members of the first respondent (pension fund) were given an option to transfer to the newly created Illovo Sugar Defined Contribution Pension Fund. A share of the surplus in the first respondent (pension fund) was offered to members who elected to transfer to the Illovo Sugar Defined Contribution Pension Fund and to take the investment risk inherent in membership of a defined contribution fund. The transfer value in respect of each member who elected to transfer from the first respondent (pension fund) to the Illovo Sugar Defined Contribution Pension fund was calculated as the greater of the member's actuarial reserve and accumulated contributions plus an enhancement of 40% on that amount.

Active members of the second respondent (provident fund) were given an option to transfer to the newly created defined contribution section of the second respondent. A share of the surplus in the

second respondent (provident fund) was offered to members who elected to transfer to the defined contribution section of the second respondent (provident fund), thereby taking the investment risk inherent in membership of a defined contribution provident fund. The transfer value in respect of each member who elected to transfer from the defined benefit section of the second respondent (provident fund) to the defined contribution section of the second respondent (provident fund) was calculated as the greater of the member's actuarial reserve and accumulated contributions plus an enhancement of 40% on that amount.

Retired Members of the first respondent (pension fund), all of whom received a monthly pension from the first respondent (pension fund), were offered an option to transfer their pension benefits to an insurance company and have their pension purchased in their own names, in which event all liability of the first respondent (pension fund) would be discharged. Where retired members of the first respondent (pension fund) took up this option, sufficient funds were paid over to the insurance company concerned to increase their pensions with effect from 1 March 1998 by 5% and to allow the payment to them, each year in December, of a thirteenth cheque.

In addition retired members of the first respondent (pension fund) who had retained the subsidy from the employer for co-payment of their medical aid premiums were given an option to discontinue the subsidy and have their pensions increased by the amount of the subsidy plus a 30% enhancement thereon.

In each of the instances where an enhanced benefit was given, there was a transfer of risk from the employer to the member concerned.

The complainant was not an active member of either the pension fund or the provident fund, nor was he a pensioner of the pension fund, thus he did not qualify for any of the above enhancements, yet he believed that he was entitled to some benefit from the surplus distribution. As a result, in August 1997 he resigned as trustee of both funds as he believed a dispute existed between himself and the trustees over the surplus distribution. He argues that when he transferred to the provident fund a portion of the surplus was transferred but not allocated to individual members and therefore he should share in this portion. In the alternative, he argues that an annuitant (like himself) is in the same position as a pensioner of the pension fund and therefore annuitants should not be excluded from sharing in the surplus. In the second alternative, he argues that he was misled regarding

the purchase of a living annuity by being advised to give up his membership of the defined benefit fund and to transfer to the provident fund for the purchase of an annuity.

In response to the main complaint, Mrs Meijer argued that the retired members of the provident fund have not been offered any enhancements because their benefits have been paid in full and they are no longer members of the provident fund. Accordingly, the rules of the provident fund do not permit such enhancements being paid. Further, given the process opted for and accepted by the complainant, and the advantages of the benefits received by him, it would not be fair and equitable to do so.

In respect of the complainant's alternative arguments, she states that when the complainant transferred from the pension fund to the provident fund an amount had been calculated and transferred to the provident fund, which included not only the duly calculated actuarial reserves of all transferring members but also a fully assessed share of the surplus in the pension fund. The amount was sufficient to ensure that the complainant would thereafter have no claim against the pension fund. When the complainant transferred he ceased to be a member of the pension fund. Accordingly, all of the obligations of the pension fund in relation to the complainant have been duly discharged.

The complainant seeks an order directing the pension fund to transfer a portion of its surplus to the provident fund and that this be paid to the complainant and the four other members who retired at the same time. Alternatively he seeks an order that he is entitled to be paid a portion of the surplus in the provident fund. In the event of my declining to grant such relief then he wishes me to set aside his transfer from the pension fund to the provident fund.

Analysis of evidence and argument

The board of management of any pension fund has a duty to distribute pension fund surpluses reasonably and in accordance with pension fund rules and the duties set out in section 7C of the Pension Funds Act of 1956.

The complainant wants a share in the surplus of the pension fund of which he was a member for over 20 years. Alternatively he wants a share of the surplus in the provident fund. Thirdly, he believes that because he is an annuitant he should fall within the definition of pensioner of the pension fund and share in the surplus distribution to this category of beneficiaries. Finally he asserts that he was misled in joining the provident fund. All these arguments raise different legal issues and I deal with them in turn.

Dealing with the complainant's first argument, it is important to note that when the complainant transferred out of the pension fund he ceased to be a member of that fund in terms of the special provisions effective from 1 February 1994. Accordingly, in terms of those provisions he is not entitled to any further benefits and has no further claims against the fund. Upon transfer to the provident fund, his actuarial value was transferred, with a portion of the surplus. This portion of the surplus for the 18 members collectively amounted to R9,872,000.00. Active members of the pension fund who transferred to the newly created defined contribution section within the pension fund were entitled to a share in the surplus. This is in line with the normal surplus distribution practice as such members would in future bear the risk of market forces in the defined contribution section. To compensate the members for this transfer in risk, their values were enhanced by 40%.

However, because the complainant is no longer a member of the pension fund and because he bears no risk in transferring to the defined contribution section his exclusion from the surplus of the pension fund is in accordance with the rules of the fund and entirely reasonable.

The complainant's second argument relates to his exclusion from the surplus distribution within the provident fund. Although in theory he was a member of the provident fund for 1 year (due to the backdating of his transfer), in practice he was only a member for 1 month, whereafter he retired from service and received his benefit in terms of the early retirement rule (quoted above). The complainant received a lump sum of R233,912.57 in cash and transferred the balance of R1,506,402,43 to Investec for the purchase of an annuity. Thus, when the complainant received his lump sum benefit and elected to purchase an annuity from an outside registered insurer, he ceased to be a member of the provident fund. Consequently the provident fund has no further liability towards him.

The complainant retired together with four other member of the provident fund in the same year. These four other members have also be excluded from sharing in the surplus distribution. This highlights the consistent application by the trustees in respect of the distribution of the surplus.

As stated, when the complainant transferred to the defined benefit provident fund, a portion of the surplus in the pension fund was transferred to the provident fund. However, the complainant does not have a right to his share in the transferred surplus. At the very best his benefit can be regarded as a *spes* in sharing in the surplus. This *spes* would have materialised into a right had the complainant remained a member of the pension fund and received a pension in terms of its rules or elected to transfer to the defined contribution section created within the pension fund. However, the complainant elected to retire early and purchase an annuity outside the fund. He followed a course whereby he voluntarily transferred his entire retirement capital out of the employer's group of funds. The surplus distribution involved enhancements to the benefits of members and pensioners who accepted a transfer of risk some two and a half years after the complainant's departure.

Thirdly, the complainant argues that he as an annuitant should be afforded the same rights as the pensioners of the pension fund. These pensioners were given the option to transfer their pension benefits to a registered insurance company and if they elected to do so their

actuarial values were enhanced to such an extent that their monthly pension would be increased by 5% from 1 March 1998 and they would also receive a thirteenth cheque. The complainant is labouring under the false premise that there is no difference between himself and these pensioners. The difference between the complainant and the pensioners of the pension fund is simple but important, namely, the complainant is no longer a member of the pension fund and he relinquished his membership of the fund because he wanted to seek his fortune elsewhere.

Fourthly, the complainant argues that he was misled in joining the provident fund. He does not substantiate this allegation but the suggestion appears to be that he was somehow misinformed in that he had to transfer to the provident fund in order to purchase an annuity. The rules of the pension fund allow for the purchase of an annuity but only to the extent of half the benefit after the one-third commutation. However, I cannot accept that the complainant was misled. The complainant was a trustee of both the pension and provident funds and ought reasonably to have been conversant with the rules and administration of both funds. When he eventually elected to transfer to the provident fund he addressed the following memorandum to the chairman of trustees of both the funds, which in part reads:

There was considerable pressure to make a quick decision and I chose then not to transfer as it had been indicated to me by the actuary that it could be possible to change the fund rules to enable a transfer direct from the fund to an individual annuity. (This avoided any tax payable, such as on transfer from a pension to provident fund).

Subsequently Graeme advised that on the basis of legal advice obtained by Alexander Forbes that such a rule change was not possible in terms of the Act.

Since then I have been exploring all avenues to transfer the maximum from the pension fund in terms of the rules, but I am left with the conclusion that the best option is to transfer to the provident fund and pay the tax and then transfer into the individual annuity.

From the memorandum it is clear that the complainant explored all "avenues" and took

advice from various sources and made an informed choice to transfer to the provident fund. The fund has referred me to another letter addressed by the complainant to Mr Willis of Alexander Forbes in which he states:

I...want to do something which our Pension Fund (first respondent) rules do not provide for. That is to transfer my total valuation at retirement into a compulsory annuity via one of the new index linked R.A.s now on the market place. If there is a tax free commutation option, I would use it in my multi-rand/multi-benefit decision. Our rules (rule 49) currently provide for up to one half of the benefit remaining after commutation...

From the above letters and bearing in mind the complainant's position as trustee, I am more than convinced that the complainant was not misled in anyway and made an informed choice without any misrepresentations or undue influence. Thus, there is no basis for setting aside his transfer to the provident fund.

In conclusion the complainant has received that to which he is entitled in law and he has been treated fairly in the circumstances. A close examination of the facts discloses that the complainant embarked upon a scheme to enable him to dis-invest his entire benefit from the pension fund in order to acquire a linked life annuity from an outside insurer. He wanted to accomplish an objective not permitted in terms of the defined benefit rules. To achieve his aim he transferred from the defined benefit pension fund to the defined benefit provident fund. A month later he retired out of the provident fund and invested his lump sum in Investec. Leaving aside the legal niceties of the scheme, fairness alone dictates that he should not be entitled to share in the subsequent surplus distribution. In effect his decision to dis-invest from the fund is an indication that he was not prepared to share in the fate of the fund and to take the risk and disadvantages of such an investment. Rather he preferred to invest in a more favourable investment vehicle elsewhere. In such circumstances there can be little claim in law or equity to share in the benefits of a windfall surplus distribution two and a half years after his departure from the provident fund.

Accordingly, for the foregoing reasons the complaint is dismissed.

DATED at CAPE TOWN this 8th day of SEPTEMBER 1999.

John Murphy

Pension Funds Adjudicator