

IN THE TRIBUNAL OF THE PENSION FUNDS ADJUDICATOR

CASE NO.:PFA/NP/29/98

In the complaint between:

J. Oudmayer

Complainant

and

Sage Group Limited Staff Pension Fund

First Respondent

Sage Life Limited (in its capacity as administrator)

Second Respondent

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

Introduction

This is a complaint in terms of section 30A(3) of the Pension Funds Act of 1956.

The complainant was an employee of the second respondent and a member of the first respondent until completion of a scheme of transfer from the first respondent to the Broll Properties Pension Fund, the fund of his new employer.

The first respondent is a pension fund duly registered under the Pension Funds Act of 1956.

The second respondent was the employer of the complainant from January 1978 until his transfer to Broll Properties on 1 March 1997, and the administrator of the first respondent.

No formal hearing has been held, and in determining this matter I have relied exclusively on the written submissions of the parties, together with the investigation and report of Ian Mc Donald, a senior investigator at my office. I am satisfied that the requirements of the Act have been complied with, and have determined the complaint as follows, for the reasons set out herein.

The complaint

The complainant was one of forty six members of the first respondent who were transferred to the Broll Properties Pension Fund with effect from 1 March 1997. Completion of the necessary formalities by the second respondent, including the provision by the Financial Services Board (FSB) of the necessary certificate in terms of section 14 of the Pension Funds Act, resulted in the final payment of the transfer of assets from the first respondent to the Broll Properties Pension Fund being made on 10 November 1997, some eight months later. During this period the amount of the transfer value applicable to the complainant increased in value from R493 777.00 as quoted on 28 February 1997 to R500 083.19 that was actually transferred to the new fund. This represents an increase of just over 1.25% over a period of eight months.

The complainant wrote to the first respondent on 19 December 1997 claiming that the transfer value should have earned market related interest at the rate of 16% and should have amounted to R554 090.00 on 21 November 1997.

After several further written and telephonic communications with both the first and the second respondent, during which he also complained that the problem had been exaggerated by unnecessary delays by the second respondent in completing the necessary formalities of the transfer, the complainant had still not received a response that was satisfactory to him, and on 21 December 1998 lodged his complaint with this office in terms of section 30A(3) of the Act.

The response of the respondents

In his response on behalf of the respondents, Mr R Mijne, Deputy General Manager, Employee Benefits Division at Sage Life explained that during the period between the date on which the benefit was originally calculated and the date on which the assets were transferred the complainant's assets continued to participate in the investment return earned by the fund, as did all other members. He went on to say:

This was a common practice, which was subsequently, vindicated by the Financial Services Board in PF Circular no 97. The basis for this being to ensure that a fund which is involved in a section 14 transfer is able to meet the requirements of the Pension Funds Act and remain in a sound financial position. In addition this method of participation in the investment return would ensure that the transfer does not detrimentally affect the reasonable benefit expectations of the members who remain on the fund.

Mr. Oudmayer's benefits were adjusted from the effective date of the transfer to the date of payment using the above method.

In response to the complainant's allegations of unnecessary delays on the part of the second respondent, Mr Mijne claims that, as administrators, they fulfilled their obligations timeously and without any unreasonable delays. A schedule outlining the sequence of events during the period in question had been supplied to the complainant, and a copy thereof was made available to my office.

The issues for determination

The issue to be determined in this matter is whether the complainant sustained prejudice as a result of any maladministration of the fund. In particular:

1. Did the fund act properly in accordance with the terms of its rules during the period in question; and

2. In applying the rules, did the fund act equitably, in the best interests of the complainant and its other members, and with due diligence.

The rules of the fund are quite specific and clear as to how a transfer of members in a situation such as this must be handled, and there is no evidence to suggest that they were applied improperly. In summary, the rules say that in the event of a transfer the Committee of Management, with the consent of the Employer, shall direct whether the transferred member will be deemed to have left service and receive a withdrawal benefit, or as in this case, that an amount equal to the Member's actuarial reserve in the fund as calculated by the actuary will be transferred to the pension fund of his new employer. It is interesting to note that had the Committee applied its first option the amount of withdrawal benefit payable to the complainant would have been R174 374.00 as against the transfer value of R493 777.00 calculated as at 1 March 1997.

The rules then go on to provide that the Committee will arrange for the transfer of the members' accrued interests in the fund, "*on a date determined by them*", and in such manner as they, in consultation with the Actuary, deem appropriate in accordance with the general principles of the rules. The members' interests in the fund in this context are to be taken as the fund's accrued liability as defined in section 16(7)(c) of the Act "*as at the date determined by the committee*". Provision is also made for the Company, in consultation with the Actuary to transfer a larger amount than this rule requires.

Section 16(7) of the Act concerns the basis adopted by the Actuary in calculating the fund's accrued liabilities for the purpose of providing periodic valuation reports to the Registrar in terms of the Act. In other words, transfer values should be calculated using the same actuarial basis as adopted in testing the solvency of the fund in valuation reports.

In his report to the registrar in terms of Section 14(1)(b) of the Act, concerning this transfer of business, Mr G F Brown in his capacity as actuary and valuator to the fund explains that a materially stronger basis than applied in the last valuation report had been used to calculate transfer values in order to give transferring members some benefit from the fact that the fund was in a

financially healthy condition.

The registrar issued a certificate in terms of section 14 of the Act, confirming that all the requirements of that section had been satisfied, on 15 September 1997. It can be assumed, therefore, that the scheme of transfer and method of calculating transfer values met with his approval in that it complied with the rules and the Act, and that it protected the interests of both those members being transferred and those remaining, equitably.

This, however, does not address the complainants' complaint that the transfer value only grew by 1.25% between the time it was calculated and when it was paid across eight months later. During this period the fund was faced with two alternatives. It could either leave the transfer assets in the fund invested in a market related portfolio pending finalisation of the necessary processes, not knowing in advance how long this might take, or it could move the transfer assets into a different investment medium as a hedge against any drop in value. The fund chose the former option as it felt that this was in the best interests of all its members. Unfortunately, as it turned out, there was a sizeable drop in the market during that period and virtually all growth was wiped out. With the benefit of hindsight it would have been to the advantage of the members being transferred had the fund taken the second option and placed the assets in a more short-term secure investment medium such as a fixed interest bearing account.

This does not necessarily mean that the fund must adjust the benefits being transferred according to what might have happened, based on the benefit of hindsight. However, we need to be satisfied that the fund acted equitably in the best interests of all its members based on known circumstances at the time the decision was taken.

In its submission the fund claims that the action it took was a common practice in the industry at the time, which was subsequently vindicated by the FSB in PF Circular No 97.

Although no reference to the investment return across the period from the effective date of a transfer to the actual date of payment was required by the Registrar at the time, this requirement has

subsequently been highlighted and become mandatory by the issue of F.S.B. Circular PF No 97, which inserts two additional questions in the forms to be submitted when applying for a section 14 certificate. These require the transferor fund to state how the assets to be transferred will be adjusted for investment return earned across the period from the effective date to the date of payment, and where a rate other than the fund rate of return is to be used, to state what action the fund has taken to protect itself against a fall in the value of assets across the period. The circular also states that

"The default should be the investment return earned by the transferor fund, positive or negative, ie the "fund rate of return".

The purpose of this new requirement is to ensure that the reasonable benefit expectations of both transferring members and those remaining in the fund are protected.

After all, in a different economic scenario the fund could also be attacked for taking what turns out to be precautionary action just prior to a major growth period in the market.

It has also been alleged by the complainant that there was undue delay in finalising the transfer, failing which the market drop could have been avoided. In a perfect world one could perhaps expect transfers of this nature to be completed fairly close to their effective date. In reality it is not uncommon for the formalities to stretch out over a period of up to a year, and even beyond. Time-scales of eight months are, unfortunately, not uncommon, by the very nature of section 14 transfers, and the industry seems to find it impossible to shorten the process. I cannot find any evidence in this case to say that the time-scale was unduly prolonged by the actions of the fund, nor that it could have been materially reduced by any different action.

The determination

The complainant is perfectly justified in questioning the apparently very low growth reflected on

what he understood to be his money, which was held by the fund, outside his control, for the seemingly inordinate length of time it took to finalise the necessary formalities of his transfer to a new fund. It is a common misconception among the public when dealing with pension fund benefits and values that they are subject to the same ground rules of capital and interest as apply in our every day financial dealings, such as with banks and building societies. In an economic environment where relatively high inflation is the norm and extremely high interest rates prevail, this can be understood, but it is none the less a misconception, particularly in the case of a defined benefit fund such as we are dealing with here.

In a defined benefit fund we are not dealing with a fixed amount of cash in the bank, but with the present value of a benefit that will emerge some time in the future, or, put another way, the amount of money the fund would require to set aside at a given point in time, and given certain assumptions as to future investment growth patterns, to meet its ultimate benefit liability in respect of a member. Clearly, this can at best only be an estimate. The true value can only be determined after the event, and the "estimated" value will fluctuate, up and down, depending on the date on which it is calculated and the way the valuator anticipates the future. So, the problem starts when a transfer value is quoted to a member as at its effective date, and the member assumes, naturally but wrongly, that this value is now his "cash in the bank", and will gather "interest" at the going rate from that date until it is actually paid over. The problem is exacerbated when in the interim period the member terminates his service with his new employer and wishes to take a cash withdrawal benefit, only to find that this new benefit does not meet his expectations.

In the case of the complainant the fund agreed to transfer an amount equal to the current value of his accrued pension benefit, not his current withdrawal benefit which would have been much lower. It also calculated that value on a generous basis in view of the healthy state of the fund, and this was then quoted to the member as his transfer value. In line with accepted industry practice at the time, the fund then allowed this value to fluctuate according to the actual investment experience of the fund until such time as it was in a position to make the transfer payment. This action was perfectly reasonable in the light of market conditions at the time the decision was taken, and in the

interests of all the members. Such practice has also subsequently been declared acceptable and equitable by the FSB in its PF Circular No 97. The fact that the fund, and as a result the member's transfer value, was adversely affected by a downturn in the market in the interim period is unfortunate, but is not due to any improper action by the fund. The fund acted properly in terms of its rules and applied these in a reasonable and equitable manner. In addition, as discussed earlier, the length of time taken to finalise the transfer was not materially lengthened by any action or lack of action by the fund, to the extent that it contributed to the low rate of growth in the transfer value.

For these reasons the complainants complaint is dismissed.

DATED at Cape Town this 24th day of June 1999

JOHN MURPHY
PENSION FUNDS ADJUDICATOR

