IN THE TRIBUNAL OF THE PENSION FUNDS ADJUDICATOR

CASE NO: PFA/WE/55/99/JM

In the complaint between:

A N Whitelock-Jones **Complainant**

and

Old Mutual Staff Retirement Fund **Respondent**

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

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1. This is a complaint related to the decision of the management board of the respondent ("the fund") to distribute the benefits of demutualisation to certain categories of members to the exclusion of others. The complainant falls into the excluded category and alleges that the distribution was unfair and that the board of the fund did not properly consider the issues of equity when arriving at a decision on the basis of allocation.

2. No hearing was held in this matter and I have relied exclusively on the documentary evidence submitted and the written submissions of the complainant and the principal officer of the fund, Mr Malcolm Rhodes.

3. The complainant was employed by Old Mutual for the period February 1987 until 31 March 1999. During the period of his employment he was a member of two pension funds. Initially he belonged to a defined benefit fund. As part of a restructuring scheme he transferred to the respondent fund, a defined contribution fund, on 1 January 1997.

4. The respondent is the Old Mutual Staff Retirement Fund, a defined contribution arrangement registered in terms of the Pension Funds Act of 1956. Rule 3 of the fund determines the contributions by members and employers in accordance with the rules. Generally, members contribute at a rate of 6.5% of pensionable earnings. The employer's contribution varies between 8.5 and 11.5% of earnings depending on the category to which a member belongs.

5. In terms of rule 10 the administration and control of the fund is vested in a management board, consisting of 8 persons, made up of 4 representatives appointed by the employer and 4 representatives elected by the members.

6. As mentioned, after 10 years of service, the complainant transferred from a defined benefit fund to the respondent fund. His transfer value was his actuarial reserve value together with a 30% enhancement as part of the distribution of the surplus in the defined benefit fund.

7. It is common knowledge that in early 1999 the South African Mutual Life Assurance Society ("the Society") was demutualised and its businesses restructured into a group of companies, of which Old Mutual plc is the ultimate holding company. The life assurance businesses outside of South Africa were transferred to various companies and the Society. Its remaining businesses, were converted into Old Mutual Life Assurance Company (South Africa) Limited ("Old Mutual"). The scheme for the demutualisation of the Society was confirmed by the High Court of South Africa (Cape of Good Hope Provincial Division) under section 25 of the Insurance Act of 1943 on 29 March 1999.

8. The details of the demutualisation are common cause and have been rehearsed in summary form in the response to the complaint as follows. Despite confirmation by the court, the scheme remained conditional in that provision was made for the scheme not to be implemented, in the event that a material change in

circumstances made implementation no longer commercially or practically prudent, or in the event of obstacles arising which could prevent the listing of the shares of Old Mutual plc on the London Stock Exchange. As events turned out, a decision was made to implement the scheme on 11 May 1999. The listing of the demutualisation shares on the London, Johannesburg and other stock exchanges took place some 2 months later - on 12 July 1999. This was the first date upon which a market value for the shares became established.

9. In terms of clause 17 of the scheme approved by the High Court, and the share allocation rules which formed an integral part of the scheme, qualifying members of the Society were allocated demutualisation shares. Generally, qualifying members were those persons who held policies with the Society.

10. Since the fund held a guaranteed fund policy with the Society which was in force on both on 31 December 1997 and on 25 September 1998, it was in terms of the share allocation rules a qualifying member of the Society and thus entitled demutualisation shares. The latter date was the qualification date, while the former date was the date used by the Society for policy valuation purposes.

11. Following the implementation of the scheme on 11 May 1999, 25,322,410 demutualisation shares were issues for the benefit of the fund. The fund will receive approximately 22, 132,878 demutualisation shares or the proceeds thereof from the SAMLAS fund (Old Mutual's defined benefit fund) in terms of an agreement to be concluded between the parties. The fund, therefore, is likely to have a total of approximately 47.5 million demutualisation shares or the proceeds thereof to deal with in terms of its rules.

12. The fund is a standard defined contribution fund and its financial structure is regulated by rule 9 of its rules. The rule generally provides that the management board shall open a bank account in the name of the fund and that all monies received by and on behalf of the fund shall be paid into the bank account until

invested with the provider. The provider is defined in the rules to mean the service providers appointed by the management board from time to time for the purposes of the administration of the fund, the investment of the monies of the fund and the purchasing of pensions in terms of the rules. In terms of rule 9.1 the provider is required to maintain certain accounts and to distribute the monies maintained between the accumulation account, the general reserve account, the employer reserve account and the stabilisation account. Each account is required to be maintained separately from the others and transfers between accounts have to take place as specified in the rules. Rule 9.2 governs the composition of the accounts and reads as follows:

9.2 COMPOSITION OF ACCOUNTS

1. Accumulation Account

The Accumulation Account shall comprise all the MEMBERS' ACCUMULATED CREDITS. Each MEMBER'S ACCUMULATED CREDIT shall comprise:

(1) Credits

(1) an opening balance comprising the MEMBER'S TRANSFER AMOUNT;

(2) total contributions by the MEMBER in terms of RULE 3.1.2(i), Rule 3.1.2(ii) and, if applicable, Rule 3.1.3;

(3) contributions by the EMPLOYER in respect of the MEMBER in terms of Rule 3.2.1;

(4) FUND INTEREST.

(2) Debits

(1) commutation value paid to the MEMBER in terms of Rule 4.3.1.

(2) transfer to the PROVIDER in terms of Rule 4.3.2 of the balance of the MEMBER'S Accumulation Account, after payment of any commutation on retirement in terms of Rule 4.1;

(3) withdrawal payment in terms of Rule 6;

(4) the death benefit paid in terms of Rule 5;

(5) transfer to the General Reserve Account of any balance of the MEMBER'S ENHANCEMENT AMOUNT not paid to the MEMBER on termination of service in terms of Rule 6.1.

2. General Reserve Account

The following transactions shall be recorded in the General Reserve Account:

(1) Credits

(1) the surplus transferred from the PREVIOUS FUND as at 1 January 1997 net of amounts attributed to MEMBERS' ACCUMULATED CREDITS and amounts attributed to the EMPLOYER reserve account;

(2) any remaining portion of a MEMBER'S ENHANCEMENT AMOUNT not paid out in terms of Rule 6.1;

(3) any amount transferred from the Stabilisation Account as contemplated in Rule 9.2.4(b)(ii);

(4) the full investment return earned by the FUND.

(2) Debits

(1) Tax payable by the FUND;

(2) Investment expense charges incurred by the FUND;

(3) Amounts declared annually by the MANAGEMENT BOARD on the recommendation of the ACTUARY which are credited to the MEMBER'S ACCUMULATED CREDIT and the EMPLOYER Reserve Account by way of FUND INTEREST;

(4) Any payment made to maintain the death benefit that would have been payable in terms of the Rules of the PREVIOUS FUND in respect of a MEMBER who dies prior to 1 July 1997.

3. EMPLOYER Reserve Account

The following transactions shall be recorded in the EMPLOYER Reserve Account:

(1) Credits

(1) The amount transferred in respect of a PENSIONER (reserve plus share of surplus in the PREVIOUS FUND) which is not needed to secure the PENSIONER'S pension;

(2) The lesser of:

- 50% of the surplus transferred in respect of a MEMBER who belonged to the PREVIOUS FUND, and

- the surplus transferred in respect of a MEMBER of the PREVIOUS FUND, net of his ENHANCEMENT AMOUNT;

(iii) FUND INTEREST

(2) Debits

EMPLOYER contributions in terms of Rule 3.2.1 and 3.2.2.

4. Stabilisation Account

The following transactions shall be recorded in the Stabilisation Account;

(1) Credits

EMPLOYER contributions for administration charges in terms of Rule 3.2.2

(2) Debits

(1) Administration expenses incurred by the FUND as advised by the ADMINISTRATOR to the MANAGEMENT BOARD from time to time;

(2) Any amount deemed by the MANAGEMENT BOARD on the advice of the ACTUARY to be in excess of that required to meet administrative expenses, which is transferred to the General Reserve Account in terms of Rule 9.2.2(a)(iii).

13. It will be seen that rule 9.2.2(a)(4) allows for the full investment return owned by the fund to be credited to the general reserve account, from which account fund interest is then drawn and credited annually to each member's accumulated credit. Fund interest is defined in the rules as being the interest declared by the management board on the recommendation of the actuary at the financial year end in respect of the previous financial year. Such declaration shall include an interim rate of fund interest to be used for benefit payments before the next interest rate is declared.

14. When the board of management realised that the fund would qualify for demutualisation shares it was concerned that the provisions of rule 9 did not cater adequately for the demutualisation accrual or other accruals of a windfall nature. It therefore decided to amend the rules by the introduction of rule 8.16. The amendment was adopted with effect from 1 November 1998 and was registered in terms of section 12(1) of the Pension Funds Act on 24 March 1999. Rule 8.16 reads as follows:

8.16 UNDISTRIBUTED PROFITS

> Any undistributed profits under the FUND arising from time to time from whatever source (but excluding the EMPLOYER reserve account) may be applied for the benefit of all MEMBERS, BENEFICIARIES, retired MEMBERS and PENSIONERS who are in receipt of pensions (including those who on retirement elected to purchase their pensions in their own names) on a basis deemed equitable by the MANAGEMENT BOARD, subject to the recommendation of the ACTUARY, may decide.

15. As the rules define members as full-time permanent employees, former members, other than retired members and pensioners, fell to be excluded from the distribution.

16. In the period between the adoption of the rule 8.16 and the distribution of the demutualisation shares to the fund, the board of management debated the question of passing on the benefits of the demutualisation windfall to the members and former members of the fund. In the minutes of the meeting of the board on 22 February 1999, the fund's consultant and actuary, Mr Chris Newell gave a presentation and reported on the process of demutualisation and its possible effects on the fund. Subsequently the board resolved that no communication would be forwarded to members until the board had decided on the terms of allocation of demutualisation shares. Mr Newell was then mandated to obtain legal opinion regarding the implications of whether members who withdrew subsequent to the value determining date of 31 December 1997 could be excluded from the allocation of shares, and if terminations by retirement, death or retrenchment were included, whether the cut-off date should be 25 September 1998, the qualifying date.

17. Eventually, on 9 June 1999, some two and a half months after the complainant had resigned his employment and withdrawn from the fund, the board of management took a final decision on the distribution of the demutualisation benefits. The resolution provides for the distribution of the benefits to a variety of stakeholders

including the employer, by means of a credit to the employer reserve, various former members who had transferred to other funds as well as to persons who had retired from the fund, death benefit beneficiaries and employees who had been retrenched since 31 December 1997. It appears from the minutes that a lengthy debate took place concerning the exclusion of voluntary withdrawals. It was eventually resolved that no demutualisation benefit would be awarded to members who had withdrawn voluntarily from the fund between 31 December 1997 and the distribution of the proceeds on the distribution date of 31 July 1999. The complainant fell into this category as he had withdrawn from the fund on 31 March 1999.

18. The reasons for the exclusion of such members are set out fully in the minutes of the meeting of 9 June 1999 as follows:

- Staff member who withdrew voluntarily made their own decision to move and did so at a point when they knew demutualisation was an issue and that the Fund could benefit, but where no details were known. It was not known whether or not these members would be eligible for value.

- Many withdrawals are small, as the bulk of withdrawals from a fund take place within a short period of joining the fund.

- The cost of tracing and making additional payments in respect of these withdrawals, could be more than the benefit.

- The members have no right to any additional benefit in terms of the Rules of the Fund.

- The Fund has operated on the principle of not giving specific surplus to withdrawing members. To give the demutualisation proceeds now to voluntary withdrawals would be different from this, and would create a precedent for a change in practice.

- Withdrawal profits have been used in the past to subsidise the bonus declaration.

- There have been over 3800 resignations since 31.12.97 and it would be administratively difficult and costly to trace and pay them all.

- Interim bonuses on withdrawals during the period 31.12.97 to 31.8.98 were larger than the actual bonuses earned, so many of these member have been advantaged over the remaining members.

19. Subsequent to this, at its meeting of 25 October 1999, the management board adopted a resolution with effect from 31 July 1999 amending rule 8.16, in order to provide in detail for the distribution of the proceeds of the demutualisation shares received, or expected to be received by the fund. At the time of responding to the complaint, approval by the Registrar in terms of section 12 was still pending. The effect of the amendment will be, *inter alia*, to establish a distribution date of 31 July 1999 as well as the basic criteria for eligibility, and notwithstanding that date to permit a distribution of demutualisation benefits to certain categories of former members whose membership terminated prior to that date - namely, those who having been members on 31 December 1997, thereafter died, retired, retrenched or became disabled. Hence, former members who resigned voluntarily before 31 July 1999 are excluded from the distribution despite their being members on the policy valuation date. In its response the fund indicates that 31 July 1999 was chosen as the distribution date because it is the end of the month in which the fund was first able to ascertain the value of the shares allocated to it and could begin to realise that value in the market place - listing of the shares on the stock exchange having taken place on 12 July 1999.

20. The complainant understandably is somewhat aggrieved at his exclusion from the distribution. He states that because the fund is a defined contribution fund he expected that all investment returns would be passed on to the members as they had carried the investment risk of poor investment performance. The investment returns allocated to his benefits in the past (fund interest) had closely followed the investment returns on the underlying assets in the guaranteed fund policy effected with the Society. On this basis he claims to have reasonably expected that the benefits arising from the demutualisation would also be passed on to all members.

21. Additionally, the complainant contends that the fund as a policy holder in the guaranteed fund received shares based on the value of the fund's assets as at 31 December 1997. These included the shares based on the value of the assets underlying his benefits in the fund.

22. I agree with the fund that those facts alone grant no additional entitlement to the complainant. In terms of rule 6 members withdrawing from the service of an employer have their accumulated credit determined as at the date of withdrawal. A subsequent investment return to the fund does not result in any credit to such members. At the date of the complainant's withdrawal from the fund no demutualisation benefit had yet accrued to the fund in that the benefit only accrued on or after 11 May 1999. Moreover, the accrual to the fund of the demutualisation shares does not constitute an investment return as contemplated by rule 9. For that very reason, rule 8.16 was introduced in 1998 to deal with the then anticipated windfall to the fund. Rule 8.16 gives no direct entitlement to the complainant to receive any distribution in respect of demutualisation benefits which were received later in 1999.

23. While it is correct that the value of the fund's policy with Old Mutual as at 31 December 1997 included the assets underlying the complainant's accumulated credit in the fund, this fact is not sufficient to entitle the complainant to a portion of the proceeds of the demutualisation shares which eventually accrued to the fund. The complainant's entitlement to share in the proceedings must be determined with reference to the rules of the fund and whether the board of management has acted reasonably and in accordance with its fiduciary duties in making the decision to exclude voluntary resignations. And this is the question requiring determination.

24. However, before examining this cardinal issue, it is necessary to deal with certain representations which the complainant alleges were made to him. Before leaving employment the complainant enquired as to whether he could leave his credit in the fund and asked about the basis of allocation of value in respect of the shares. He

was informed that it was not permissible to leave his credit in the pension fund after leaving service. He nevertheless claims to have relied on certain resolutions of the management board at its meeting of 26 October 1998 regarding the distribution and thus left the employ of Old Mutual "secure in the knowledge that ex-members of the scheme would be treated equitably in the allocation of value in respect of the demutualisation shares". In this regard, he relies on a letter addressed to him by Mr Malcolm Rhodes, the principal officer of the fund, dated 19 January 1999. The resolution of the board is cited in the letter and reads as follows:

> (1) As far as pragmatically possible a principle of complete equity be applied throughout in dealing with past and current members, once the details regarding the cut-off date for demutualisation were known.
>
> (2) That the actuary and consultant prepare a proposal for consideration by the management board on this matter once details were available.

25. The complainant's reliance on this resolution as an indication that he would benefit from the demutualisation was unfounded, and perhaps even unwise. This is particularly so because the resolution is quoted by Mr Rhodes with a number of caveats. In the letter Mr Rhodes makes it explicitly plain that no guarantees were being offered. He states:

> It is not possible to be specific on this matter, as at present the exact basis for allocation of shares is not known. The management board will try to ensure that the principle of equity is achieved in distributing the value of the shares received and that as far as possible members in similar situations, including pensioners receive similar allocations of value.

26. Mr Rhodes, after citing the resolution, then goes on to state:

> At this stage, I therefore cannot confirm what the effect will be on your withdrawal benefit should you decide to resign on 31 March 1999, but the management board will take into account the fact that members have exited the fund for various reasons before and after the cut-off date.

27. Hence, the complainant's reliance on the resolution as an indication that he would be a recipient of a demutualisation distribution was misplaced. Mr Rhodes was unequivocal that no guarantees could be given and the complainant, an educated man, resigned in full knowledge of that fact and thus voluntarily assumed the risk of being excluded from the distribution.

28. Hence, the principal inquiry in this matter is whether the decision of the board of management, and the subsequent rule amendment excluding persons who had resigned after 31 December 1997, was reasonable and in accordance with the board's fiduciary duties.

29. Section 7C of the Pension Funds Act provides that in pursuing its object the board of management shall act with due care, diligence and good faith and that it should act impartially in respect of all members and beneficiaries. The term "member" is defined in the Pension Funds Act to include any member or former member of the fund.

30. Of particular relevance to this matter is the duty of the board to act impartially which requires that the board should not discriminate unfairly against different categories of members. It does not follow that the board is not entitled to treat members and former member differently. It requires rather that the board in making distinctions should pursue a legitimate purpose by rational means. The decision of the board to exclude resignees should be legitimate and rational.

31. The management board relied on two comprehensive reports compiled by the actuary and consultant to the fund and duly considered the question as to how to deal with the demutualisation shares at four meetings, namely, 22 February 1999, 9 June 1999, 27 July 1999 and 25 October 1999. As far as the distribution of shares to members and former members was concerned, the board adopted the following principles:

- equity between individual members of the fund is generally important;
- fund members who had similar length service and accumulated credits should receive similar benefits from the demutualisation proceeds, based on the situations and options available to them.

32. The fund has advanced a comprehensive justification for the decision which it has taken. Firstly, it contends that its approach is consistent with past practice in respect of members who leave the fund on account of voluntary resignation. The fund has always operated on the principle of not adjusting retrospectively the benefits paid to the withdrawing members as a result of a subsequent surplus emerging. For example, the vesting of the enhancement on transfer from the defined benefit SAMLAS pension fund to the fund was phased in over 36 months for voluntary resignations. Any profits from this source were applied to the benefits of remaining members only.

33. The management board saw its primary duty as being towards the fund and its current members and pensioners, it therefore felt that the benefits arising from the demutualisation should only be distributed to former members if there were strong considerations in fairness and equity to benefit such persons.

34. In this regard, the board felt that exits from the fund as a result of retirement, death, disability and retrenchment should be viewed differently from resignations. These former members made their own decisions to resign from Old Mutual and therefore to withdraw from the fund and did so in the majority of cases at a point when they knew that demutualisation was an issue and that the fund could benefit, but where details were unknown. The board thus considered it fair to draw the inference that these former members in making their decision to give up their employment with Old Mutual and withdraw from the fund were prepared on balance to forsake such benefits or at least take the risk that they would not receive any benefit. It is clear from the minutes of the meeting on 9 June 1999, that the board was also influenced

by issues and concerns of administrative convenience.

35. The complainant fundamentally disagrees with the fund. While he appreciates that the value of the demutualisation proceeds belong to the fund, he contends that this value should be passed on to all members that gave rise to that value. He believes that to allocate the value of the resigned members or to the employer would be inequitable. In essence, he asks me to review the merits of the board's decision and to substitute my own decision as to what a fair distribution of the proceeds of demutualisation would be in the circumstances.

36. The complaint raises important questions about the nature and extent of the duty of the board of management to act with impartiality in respect of all members and beneficiaries, and the test to be applied by my office when reviewing the board's exercise of discretionary power.

37. These matters have recently been canvassed fully by the Court of Appeal in the United Kingdom in *Edge & Others v Pensions Ombudsman and another* [1999] 4 All ER 546 (CA). The jurisdiction of the Pension Funds Adjudicator in South Africa is modelled largely on the jurisdiction of the Pensions Ombudsman in the United Kingdom under section 146 of the Pension Schemes Act of 1993, and thus much of what is said in the judgement of the Court of Appeal is of significance and deserves full discussion here.

38. In 1993 the trustees of the ITB Pension Fund, acting under a power of amendment, amended the scheme's rules in order to take account of an actuarial surplus. The amendments reduced the employees' and employer's contributions, and provided an additional service credit for those members in service on 1 April 1994. In this way the trustees sought to reduce the actuarial surplus, which was essential otherwise the scheme would loose its exemption for tax on some part of the income from its open fund investments. A number of pensioners who were excluded from the surplus distribution lodged a complaint with the Pensions Ombudsman. The

Ombudsman concluded that the trustees had acted in breach of trust by showing undue partiality to the interests of the preferred beneficiaries and directed that the scheme be administered on the basis of the pre-amended rules and that the trustees should seek payment of the full compensation due from members and the employer. In the High Court, the Vice-Chancellor held that the Ombudsman was not entitled to interfere with the trustees' decision simply because, in his opinion, the partiality shown towards the preferred beneficiaries was "undue", and that, in any event, the trustees had not been under any duty to act impartially between members in service and pensioners members. In his judgement the Vice-Chancellor rejected the Pension Ombudsman's finding that the trustees had been under a duty to act impartially in the sense understood by the Pensions Ombudsman.

39. The Ombudsman had explained his understanding of the duty to act impartially in paragraph 41 of this determination as follows:

> The Trustees' duty to act impartially between the different beneficiaries does not equate with a duty to exercise their discretion on all occasions in such a way as to produce equal benefits of equal value to all beneficiaries. Nor does it even require that all beneficiaries receive some benefit from an exercise of discretion. It is permissible to exercise a discretion in such a manner as to omit particular beneficiaries or a class thereof. But the decision to exclude those beneficiaries must not be the result of undue partiality towards the interests of the preferred beneficiaries.

40. In the view of the Pensions Ombudsman therefore the duty of impartiality would be breached where the trustees could be shown to have no concern for the interests of the excluded beneficiaries. It could also be breached where the decision to prefer a particular group of beneficiaries was taken for reasons which were not appropriate to the trust in question. He put it as follows in paragraph 43 of the determination:

> As partiality towards a group of beneficiaries can be the result not only of a lack of regard towards other beneficiaries, but preferring one group for the wrong reasons, there is an overlap between the duty of impartiality and the duty to act in the best interests of all the

> beneficiaries and the duty to exercise a discretion fairly and honestly and for the purposes for which they are given and not so as to accomplish any ulterior purpose.

41. In the judgement of the High Court, the Vice-Chancellor agreed with much of what the Pensions Ombudsman had said, but differed on a fundamentally important point. There the learned judge stated:

> Bar the final sentence, I would fully agree with everything in para 41. The last sentence, however, distorts, in my opinion, what has gone before. What is "undue partiality"? The trustees are entitled to be partial. They are entitled to exclude some beneficiaries from particular benefits and to prefer others. If what is meant by "undue partiality" is that the trustees have taken into account irrelevant, improper or irrational factors, their exercise of discretion may well be flawed. But it is not flawed simply because someone else, whether or not a judge, regards their partiality as "undue". It is the trustees' discretion that is to be exercised. Except in the case where the discretion has been surrendered to the court, it is not for the judge to exercise the discretion. The judge may disagree with the manner in which the trustees have exercised their discretion but, unless they can be seen to have taken into account irrelevant, improper or irrational factors, or unless their decision can be one that no reasonable body of trustees properly directing themselves could have reached, the judge cannot interfere. In particular, he cannot interfere simply on the ground that the partiality showed to the preferred beneficiaries was in his opinion undue.

42. In relation to the overlap between the duty of impartiality and the duty to act in the best interests of all the members to which the Ombudsman had referred in paragraph 43 of the determination, the Vice-Chancellor remarked as follows:

> Neither a duty to act impartially nor a duty to act in the best interest of all the beneficiaries describes, in my judgement, the nature of the duty of the trustees when considering what steps to take to deal with the surplus. They had a discretionary power to make amendments to the rules in order to provide additional benefits to members, whether pensioners or still in service. It was within their discretion to provide benefits to members in service to the exclusion of members no longer in service. They certainly had a duty to exercise their discretionary power honestly and for the purposes for which the power was given and not so as to accomplish any ulterior purposes. But they were the judges of whether or not their exercise of the power was fair as between the benefited beneficiaries and other beneficiaries. Their exercise of the discretionary power cannot be set aside simply because

> a judge, whether the Pensions Ombudsman or any other species of judge, thinks it was not fair.

43. In the Court of Appeal Chadwick LJ at 560C usefully summarises the Vice-Chancellor's attitude to the Ombudsman's approach to reviewing the matters which the trustees had said that they had taken into account in reaching their decision:

> He pointed out that the true question, in relation to those matters, was not whether the ombudsman thought that they were sufficient to justify the decision; but whether they were matters to which the trustees were entitled to have regard at all. The ombudsman had applied the wrong test. He had asked himself whether in the light of those matters, he thought that the decision was "fair". The correct approach was to ask whether the matters were irrelevant; so that the trustees could be said to have acted irrationally or improperly in taking them into account. If the trustees were entitled to take these matters into account, then it was for the trustees - and not for the ombudsman - to decide what weight those matters should be given. In particular, it was for the trustees to decide whether the fact that pensioners were already adequately provided for by past increases and benefits and by index-linking was a sufficient ground for excluding them from further benefits. The fact that the pensioners were already adequately provided for (which was not challenged) could not be dismissed as irrelevant. The trustees' decision to give weight to that fact could not be categorised as irrational or improper. Further, the trustees were bound to have regard to the fact that the employer's consent had to be obtained but it was for them to decide how far the employers could be pressed in negotiation. It was not for the ombudsman to substitute his own judgement for that of the trustees on a matter of that kind.

44. Such an approach accords very much with the traditional approach to administrative law review in South Africa. Here too a court normally will merely require the decision-makers to take relevant consideration into account and will not prescribe the weight that must be accorded to each consideration. The reason for this is that such a requirement could constitute a usurpation of the decision-maker's discretion - see *Durban Rent Board v Edgemount Investments Ltd* 1946 AD 962.

45. On appeal in the *Edge* matter, the Pensions Ombudsman contended amongst other things that the Vice-Chancellor was wrong to hold that, in the exercise of their discretionary power to amend the rules, the trustees were not subject to a duty to

act impartially as between individuals or classes of beneficiaries; and was wrong to hold that the trustees were themselves the judges of whether the exercise of the power was fair as between included and excluded beneficiaries.

46. Lord Chadwick when considering the trustees' decision to distribute the surplus held that there was no obligation to make any change to the benefits payable under the rules simply because there was a surplus. Nevertheless, the actuary's report provided an opportunity for the trustees to consider whether the benefits payable under the scheme should be increased. In this regard at 565h he said:

> They were obliged to consider whether to increase benefits; but, after consideration, they could have decided not to do so. They could have decided to maintain the fund in balance - on the basis of unchanged benefits - by appropriate adjustments to the contribution rates, using the tools which we have described. If they had reached that decision after proper consideration of the alternatives, they could not have been criticised. The beneficiaries had no right to insist on an increase in the benefits: see the observations of Knox J in *LRT Pension Fund Trustee Co Ltd v Hatt* [1993] OPLR 225 @ 265. Their right was to have the matter properly considered.
>
> The right to have the matter properly considered gives rise to the requirement that, if there is an actuarial surplus after providing for the estimated liabilities, the trustees must, in deciding whether or not to increase the benefits (and if so which benefits), act in a way which appears to them fair and equitable in all the circumstances; and so leads to a reasonable expectation amongst the beneficiaries that that is what will be done; see the observations of Nicholls V-C in *Thrells Ltd v Lomas* [1993] 2 All ER 546 @ 557.

47. The learned judge then went on to elaborate on what the obligation to properly consider increasing benefits will usually require. In particular he felt that in deciding what is fair and equitable in the circumstances the trustees may be expected to give weight to the circumstances in which the surplus has arisen and the claims of those whose contributions were the effective source of the surplus. However, he outlines the correct approach to be taken by the trustees and the courts in the following terms:

The need to consider the circumstances in which the surplus has arisen does not lead to the conclusion that the trustees are bound to take any particular course as a result of that consideration. They are not constrained by any rule of law either to increase benefits or to reduce contributions or to adopt any particular combination of these options. Nor does the need to consider the circumstances in which the surplus has arisen lead to the conclusion that the trustees are not required to take - or are prohibited from taking - any other matters into account in deciding what course to adopt. They must, for example, always have in mind the main purpose of the scheme - to provide retirement and other benefits for employees of the participating employers. They must consider the effect that any course which they are minded to take will have on the financial ability of the employers to make the contributions which that course will entail. They must be careful not to impose burdens which would imperil the continuity and proper development of the employers' business or the employment of the members who work in that business. The main purpose of the scheme is not served by putting an employer out of business. They must also consider the level of business under their scheme relative to the benefits under their scheme relative to the benefits under comparable schemes; or in the pensions market generally. They should ask themselves whether the scheme is attractive to the members whose willingness to continuing paying contributions is essential to its future funding. Are the benefits seen by the members to be good value in relation to the contributions; would the members find it more attractive to pay higher contributions for higher benefits; or to pay lower contributions and accept lower benefits? The main purpose of the scheme is not served by setting contributions and benefits which deter employees from joining; or which causes resentment. And they must ask themselves whether the benefits enjoyed by members in pension have kept up with increases and the cost of living; so that the expectations of those members during their service - that they were making adequate provision for their retirement through contributions to an occupational pension scheme - are not defeated by inflation.

The matters to which we have referred are not to be taken as an exhaustive or a prescriptive list. It is likely that, in most circumstances, pensions trustees who fail to take those matters into account will be open to criticism. But there may well be other matters which are of equal or greater importance in particular circumstances with which trustees are faced. The essential requirement is that the trustees address themselves to the question what is fair and equitable in all the circumstances. The weight to be given to one factor as against another is for them.

48. Referring then to the duty to act impartially the learned judge concludes:

> Properly understood, the so called duty to act impartially - on which the ombudsman placed such high reliance - is no more than the ordinary duty which the law imposes on a person who is entrusted with the exercise of a discretionary power; that he exercises the power for the purpose for which it is given, giving proper consideration to the matters which are relevant and excluding from consideration matters which are irrelevant. If pension fund trustees do that, they cannot be criticised if they reach a decision which appears to prefer the claims of one interest - whether that of employers, current employees or pensioners - over others. The preference will be as a result of a proper exercise of the discretionary power.

49. In the case under consideration the Court of Appeal felt that it had not been shown that the trustees had misdirected themselves, or had made an irrational decision. Accordingly, there were no grounds upon which the Ombudsman could properly have found that the trustees had acted in breach of their fiduciary duties.

50. Such a deferential approach is consistent with the traditional approach to administrative law followed in South Africa. The principles of review of administrative discretion have developed both in South Africa and England in a casuistic manner over the years and are premised largely on a system characterised by legislative sovereignty. In that context our courts generally have been reluctant to assume a power to set aside discretionary decisions on the grounds of substantive unreasonableness. Thus, in *Union Government v Union Steele Corporation (South Africa) Ltd* 1928 AD 220 @ 236-7, Stratford JA stated:

> There is no authority that I know of, and none has been cited, for the proposition that a court of law will interfere with the exercise of a discretion on the mere ground of its unreasonableness. It is true the word is often used in the cases on the subject, but nowhere has it been held that unreasonableness is sufficient grounds for interference; emphasis is always laid on the necessity of the unreasonableness being so gross that something else can be inferred from it, either that it is “inexplicable except on the assumption of *mala fides* or ulterior motive”... or that it amounts to proof that the person on whom the discretion is conferred has not applied his mind to the matter....

51. The apparent judicial reluctance to recognise substantive unreasonableness as a ground of review was based upon the view that review on such grounds would lead to an undermining of the barrier between review and appeal.

52. Subsequent to the adoption of fundamental constitution incorporating a bill of rights, such a deferential view has given way to a somewhat different approach. In *Roman v Williams NO* 1998 (1) SA 270 (C) van Deventer J held that under a fundamental constitution the requirements of reasonableness introduce a test of proportionality between the object of a decision and the means applied to giving effect of that decision. This means that judicial review is no longer limited to scrutinising the way in which an administrative decision is reached, but can involve scrutiny of the substance and merits of that decision. Hence, it is permissible to look at the purposes, means and effects of an exercise of discretionary power.

53. Such an interpretation raises the difficult question of whether a more interventionist approach should be followed in reviewing the decisions of administrative functionaries, or in this case boards of management of pension funds. Does the Pension Funds Act, read together with the Constitution, envisage a system of merits review different to the more limited deferential approach such as that imposed on the Pensions Ombudsman in the United Kingdom by the Court of Appeal in the *Edge* decision?

54. Merits review is the process whereby decisions are reviewed on the merits, meaning that the facts, law and policy aspects of the original decision are all reconsidered afresh and a new decision either affirming, varying or setting aside the original decision is made. Merits review involves a capacity for substitution of the decision of the reviewing person or body for that of the original decision maker.

55. Merits review has been applied most conspicuously in Australia. There the Administrative Appeals Tribunal may review decisions on the merits and stands in the shoes of the original decision maker. This formulation is generally accepted in

Australia and represents a standard common not only to the Administrative Appeals Tribunal but to all other specialist tribunals. The Australian Ombudsman for example may undertake a form of merits review while investigating government maladministration, but this is limited in that he or she does not have the power to substitute a decision for that of the original decision-maker and is limited to making recommendations. Nevertheless, other social security tribunals do indeed substitute decisions on the basis of the merits. In *Better Decisions; Review of Commonwealth Merits Review Tribunals*, Report no. 39 of the Administrative Review Council, merits review is described as follows:

> Merits review is often described as a process by which the person or body reviewing the decision "stands in the shoes" of the original decision maker... This is because the reviewing person or body, like the original decision maker, must make findings of fact and apply the relevant rule to those findings to make a decision, having regard also to any relevant government policy. In addition, the reviewing person or body may only exercise the powers and discretions that were available to the original decision maker.

56. The objectives of merits review are stated in the Report to be the following:

- to achieve correct and preferable decisions;
- to be accessible and responsive;
- to promote better quality decision making by agencies;
- to allow improvements to policy and legislation;
- to be coherent; and
- to make efficient use of resources.

57. Merits review exists in South Africa to some extent in the employment arena under the auspices of the Commission for Conciliation, Mediation and Arbitration; and previously was applied by the Industrial Court. These tribunals generally have been willing to substitute their own decisions on questions of fairness for those of the employer in unfair dismissal and unfair labour practice cases - see *General Industries Workers' Union of SA v Eggo Sand* (1990) 11 *ILJ* 821 (IC).

58. Because the complainant wishes me to review the merits of the decision of the board of management, the question to be answered in this instance can be formulated as whether the Pension Funds Act permits me to substitute my decision for the decision of the board of management to distribute the demutualisation proceeds in the way in which it did.

59. Section 30D of the Pension Funds Act describes the main object of the Adjudicator to be that of disposing of complaints lodged in terms of the Act in a procedurally fair, economical and expeditious manner. The definition of a complaint identifies four possible causes of action related to the administration of the fund, the investment or its funds or the interpretation and application of the fund's rules. Those four causes of action are:

- that a decision of the fund or any person purportedly taken in terms of the rules was in excess of the powers of the fund or person, or an improper exercise of its powers;

- that the complainant has sustained prejudice as a consequence of maladministration of the fund by the fund or any other person;

- that a dispute of fact or law has arisen in relation to a fund between the fund or any other person and the complainant; or

- that the employer participating in the fund has not fulfilled its duties in terms of the rules of the fund.

60. No explicit guidance is provided by the statute as to whether a merits review was intended or not. The definition of a complaint is borrowed largely from the United Kingdom Pension Schemes Act of 1993, and that may support an argument that the more deferential English approach was intended. And this would be especially

the case in instances where the cause of action is an allegation that the decision of the fund or any person purportedly taken in terms of the rules was in excess of the powers of the fund or an improper exercise of the fund's powers. In other words, when the cause of action alleges *ultra vires* or an improper exercise of powers, the statute intended a process of review along traditional administrative law lines. The difficulty comes in attempting to give meaning to the concept of maladministration or where a dispute of law arises in relation to a constitutional matter. In these instances depending on the issues and circumstances there may be some room for arguing that a quasi-merits review would be more appropriate.

61. In view of the innovative nature of merits review, and the extensive incursion upon the rights of decision-makers which it entails, one is naturally cautious to apply it without a clear legislative indication in that regard. This area of the law is in a state of development and one naturally should proceed cautiously - see *Commissioner of Customs and Exercise v Container Logistics (Pty) Ltd* 1999 (3) SA 771 (SCA). Moreover, merits review is generally considered inappropriate where a decision involves significant polycentric elements such as the apportionment of finite resources, or where review would require a wide inquiry involving the competing interests of several parties. (See Cheryl Saunders: *Appeal or Review: Administrative Appeals in Australia* in Corder and McLennan *Controlling Public Power: Administrative Justice through the Law.)*

62. Whatever the case, in this instance I am disinclined to upset the board's decision on the merits, and am prepared to limit the investigation to testing the legitimacy and rationality of the board of management's decision.

63. The complainant had no pre-existing right to share in the surplus realised by demutualisation. On withdrawal he received his share of the fund (as determined by the rules) on the values applicable at that date. Any expectation he may have entertained ought to have been tempered by the principal officer's letter of 19 January 1999. Like the Court of Appeal in *Edge*, I accept the proposition that the

need to consider the circumstances in which the surplus has arisen does not lead to the conclusion that the board of management is bound to take any particular course as a result of that consideration. Likewise, I agree that the so-called duty to act impartially is akin to the ordinary duty which the law imposes on a person who is entrusted with the exercise of a discretionary power that he exercise the power for the purpose for which it was given, giving proper consideration to the matters which were relevant and excluding from consideration matters which are irrelevant.

64. The board of management fully debated the distribution of the demutualisation proceeds during four meetings and sought to strike a balance between the needs of the active members, the recently retired pensioners, other beneficiaries, former members and the employer. They were clearly motivated to find an acceptable solution and had to draw limits with reference to criteria which they were in the best position to determine. Their decision to benefit former members who had left the fund since 31 December 1997, but excluding those who had resigned, was motivated by legitimate reasons and a sound policy to benefit those who had left through no fault or will of their own, as well as issues of administrative convenience.

65. The board of management is entitled to exclude some beneficiaries from particular benefits and to prefer others. It is the trustees' discretion that has to be exercised in this regard. It is not for the judge or the Adjudicator to exercise that discretion. The Adjudicator or judge may very well disagree with the choices made by the board of management when it exercised that discretion or with the content of its decision. But unless the board can be seen to have taken into account irrelevant, improper or irrational factors, or unless their decision can be said to be one that is illegitimate in the sense that no reasonable board of trustees properly directing themselves could have reached it, the Adjudicator should not interfere by reviewing the merits of that decision, especially where, as in this case, the decision involves a polycentric apportionment of finite resources and would require a wide inquiry involving the competing interests of several parties.

66. The principal consideration in excluding the resignees in the instant case seems to have been that those who voluntarily withdrew made their own decision to move and did so at a point when they knew demutualisation was an issue. In other words, they voluntarily assumed the risk of not falling within the pool of beneficiaries. Moreover, many of them had been advantaged by favourable interim bonuses larger than the actual bonuses earned, and an earlier distribution of the surplus in the SAMLAS defined benefit fund. And therefore like the trustees in the *Edge* case in deciding to exclude the pensioners, the board of management in all likelihood considered that the favourable interim bonuses and past increases adequately provided some equity for many of the resignees. Besides this, as stated, there were numerous practical reasons which justified their exclusion, all of which appear to have been legitimate and rational.

67. In urging me to attach definitive weight to the fact that the proceeds of demutualisation derive in part from the assets underlying his benefit, a factor apparently considered by the board, the complainant seeks to have me substitute my decision for that of the board on the weight to be accorded to such a consideration. As was made explicitly plain by the Court of Appeal in *Edge*, the weight to be given to one factor as against others is for the board, not the Adjudicator. A board will always have to weigh some matters and interests against others and to determine which in its opinion are of greater importance. And, therefore, as already explained, the polycentric elements and wide ranging nature of the competing interests involved in a surplus distribution naturally invite a measure of judicial deference in the absence of any illegitimacy or irrationality in the decision-making process. There is no evidence of such in this case.

68. Accordingly, I can find no reason to interfere with the decision of the board of management and for that reason the complaint is dismissed.

Dated at CAPE TOWN this 21st day of February 2000.

John Murphy

Pension Funds Adjudicator