

**IN THE TRIBUNAL OF THE PENSION FUNDS ADJUDICATOR**

CASE NO: PFA/WE/300/98/NJ

In the complaint between:

**C Fourie & Others**

**Complainant**

and

**KWV Pensioenfonds**

**Respondent**

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

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1. This is a complaint lodged with the Pension Funds Adjudicator's office in terms of section 30A(3) of the Pension Funds Act of 1956 (hereinafter referred to as "the Act"). The complaint relates to the distribution of the surplus in an ongoing fund amongst various stakeholders.
1. No hearing was held in this matter. Accordingly, in determining this matter I have relied exclusively on the documentary evidence, submissions and additional information obtained during a series of telephonic conversations, all gathered during the course of Mr Jeram's investigation.
2. The complainants are Mr C Fourie, Mr JA van Schalkwyk and Mr Louw, a group of pensioners, who all retired from the respondent.
3. The fund is KWV Pensioenfonds, a pension fund duly registered under the Act (hereinafter referred to as "the fund"). The fund was initially a defined benefit fund. However, with effect from 1 January 1998, the fund introduced a defined

contribution section within the fund. All members joining the fund after this date became members within the defined contribution section. The fund is represented by Mr E Mouton, the principal officer of the fund, and Mr Coenie Louw, the regional manager of ABSA, the consultants and actuaries to the fund.

4. As stated, Mr Fourie, Mr Louw and Mr van Schalkwyk all retired from the fund. They elected to take one-third of their retirement benefit in cash and the balance was used to purchase a pension payable by the fund. After the complainants' respective retirement dates, the fund commenced the payment of a monthly pension to them.
  
5. The statutory valuation report of the fund as at 31 December 1995 reflected the fund to be in a healthy financial position. There was a market value surplus of approximately R20 million and the funding level was 120%. No formal valuation was done in respect of the funding level as at September 1997 or January 1998, thus it is not possible to determine the exact value of the surplus available for distribution at either of the above dates. Approximate calculations performed in the actuarial valuation as at 1 July 1998 showed that the fund had a funding level of 137% as at 1 January 1998 and approximately R30 million surplus.
  
6. During 1997, the fund considered introducing a defined contribution section and outsourcing the pensioners. On 17 September 1997, the trustees decided to effect the following distribution:
  - 'n aanbod word aan pensioenarisse gemaak dat hul pensioene by 'n versekeraar aangekop word wat na verwagting 'n verhoging van ongeveer 15% in hul pensioene tot gevolg sal hê.
  
  - 'n toedeling van 30% aan lede van die fonds wat die opsie uitoefen om na die vaste bydrae pensioenfonds oor te skakel.

- Gadesterftevoordele voor aftrede wysig na 40% van salaris en lede wie se posisie verswak, ontvang 'n randwaarborg. Lede wat agterbly in die fonds, se posisie bly onveranderd
- ongeskiktheidsvoordele staak op ouderdom 60 jaar. Huidige lede wie reeds 'n ongeskiktheidsvoordeel ontvang en oorskakel na die vaste bydrae pensioenfonds, se ongeskiktheidsvoordele staak soos bepaal deur die reglement van die huidige fonds.
- die koste van die verpligtinge t o v betrokke lede met wie by indienstrede of aanstelling ooreenkomste aangegaan is, en wie die keuse uitoefen om na die vaste bydrae pensioenfonds oor te skakel, se verhoogde voordele volgens bestaande praktyk by die omskakelings waarde gevoeg word.

8. On 17 November 1997 the fund called an information meeting involving all pensioners in respect of the choices available. From the evidence before me it is not entirely clear what transpired at the meeting. However, it appears as if an agreement was reached whereby the pensioners would receive a 20% enhancement of the actuarial reserve values and the transfers to be effective from 1 March 1998. Sanlam was the only registered insurer from which a pension could be purchased. However, Mr Louw was dissatisfied with this enhancement, in particular the fact that there was a different enhancement for active members as opposed to the pensioners. He requested his dissatisfaction to be noted in the minutes of the meeting. Mr Louw also objected to the pensioners only being given the choice of Sanlam as the registered insurer.

9. Hereafter, there was an exchange of correspondence between the fund and the pensioners in respect of the enhancement and registered insurers available. Eventually, on 26 November 1997, the trustees of the fund decided to grant each pensioner a 20% enhancement of his or her actuarial reserve value. In addition, the pensioners had a choice of transferring their pensions either to Sanlam or Old Mutual or purchase a living annuity from either of the two insurers (provided the

actuarial reserve value of the pensioner exceeded R400,000). On 14 January 1998, the fund sent a letter to all the pensioners requesting them to exercise their options. The relevant rule regulating the outsourcing of pensioners, in part, reads:

AANKOOP VAN PENSIOENE

Met ingang van 1 Januarie 1998 word alle pensioene wat of 31 Desember 1997 deur die FONDS aan BEGUNSTIGDES betaalbaar is deur die FONDS by'n VERSEKERAAR van die TRUSTEES se keuse aangekoop.

Die bepalings met betrekking tot die betaling van elke pensioen wat sodanig aangekoop word sal in ooreenstemming wees met die bepalings van artikel 7 en 8 van Bylae A na gelang van die geval.

Section 7 and 8 of schedule A sets out the terms of the pensions payable to the complainants from the fund prior to 1 January 1998.

10. All the complainants elected to transfer their reserve values to Old Mutual. Their respective transfer values were composed as follows:

	Reserve Value	Enhancement	Enhancement %	Transfer Value
Mr Fourie	R 831,425	R222,701	26,79	R1,054,126
Mr Louw	R1,501,406	R422,442	28,14	R1,923,848
Mr van Schalkwyk	R 419,875	R124,808	29,73	R 544,683

Eventually, an amount of R58.6 million (asset value of the pensioners) was transferred to Old Mutual and Sanlam, which included a sum of roughly R11.8 million representing the surplus (enhancements). The complainants' respective enhancements were greater than 20% for reasons which will appear below. No portion of the surplus was retained in the defined benefit section of the fund as no

member opted to remain in this section. Furthermore, no portion of the surplus was awarded to the employer or any other stakeholder other than the active members transferring to the defined contribution section of the fund.

11. The complainants were dissatisfied with their respective transfer values. They advanced four reasons for their dissatisfaction. Firstly, the complainants argued that the enhancement for active members and pensioners should be the same. Secondly, they contended that the enhancement should be applied to their full benefit as at retirement (before any commutation). Thirdly, the increases given to the pensioners were lower than the inflation rate and investment return and growth rate of the fund. Thus, they argue that the pensions should be brought in line with inflation and the investment return of the fund and thereafter the enhancement should be applied.
12. The complainants' fourth argument relates to the definition of pensionable emoluments, which reads:

PENSIOENGEWENDE SALARIS

Die basiese salaris of loon wat die WERKGEWER volgens sy rekords aan 'n LID betaal verhoog met 10% daarvan, asook ander gereelde inkomstes wat deur die WERKGEWER As pensioengewend geag word.

The 10% enhancement came into effect on 1 March 1994. The complainants, who all retired prior to this date, argued that their exclusion from this benefit amounts to unfair discrimination.

13. Mr Mouton, in his response to the complainants' first argument stated that pensioners were out-sourced on the same terms applicable to them within the fund. However, the pensioners would enjoy greater security as huge insurers such as Sanlam and Old Mutual will always provide greater security than the fund. Further,

in 1996 the Minister of Finance indicated that retirement benefits of active members will be a tax target whereas pensioners were not affected. The first step was taken by the South African Revenue Services in 1997 with the introduction of the 17% tax on interest and rental income of the fund. This rate was increased 25% for the 1998/1999 tax year. According to Mr Mouton, the greater tax risk of active members (as opposed to pensioners) was an important consideration in differentiating between pensioners and active members in respect of the enhancement.

14. Mr Mouton further argued that the fund in the past had awarded greater pension increases than the investment return of the fund (as will appear more fully below). Thus, he concluded that due to the greater tax risk for active members and pensioners receiving annual increases over and above the investment return of the fund, required the trustees to consider a different enhancement rate for pensioners and members. The enhancement for pensioners was initially 15% which was later increased to 20%. However, upon the eventual transfer of the pensioners the enhancement exceeded 20%, as upon transfer to the respective insurers due to the different actuarial assumptions made by the insurer's actuaries as opposed to that of the fund, it turned out that the cost of the pensions were much higher than that predicted by the fund. Accordingly, all the pensioners were granted a greater enhancement. Mr Fourie, Mr Louw and Mr van Schalkwyk's respective enhancements were 26,79%, 28.14% and 29,73%. Hereafter, all pensioners who joined Sanlam further enjoyed the benefits of the demutualisation process. The total value of these benefits amounted to R2 755 000 which were allocated on a pro-rata basis amongst Sanlam pensioners. They had the option of a lump sum or a pension increase and the benefits were paid with effect from September 1999. Thus, the pensioners moving to Sanlam in effect received an enhancement greater than 30%.
15. With regard to the complainants' third argument that their increases were not in line

with the investment return of the fund and inflation rates, Mr Mouton responded as follows:

Tot in 1987 is voorsiening vir pensioenverhogings gemaak tot die mate waartoe die aktuariële beleggingsopbrengs op the bates van die fonds 'n koers van 8% per jaar oorskry. Dit het die effek gehad dat indien 'n aktuariële beleggingsopbrengs van 15% per jaar behaal is, 'n verhoging van 7% per jaar, i.e. 15% - 8%, toegestaan kon word. Hierdie voorsiening is op 1 Januarie 1990 met 1% per jaar en op 1 Januarie 1993 met 'n verdere 2% per jaar verhoog deur die na aftrede rentekoers na 7% en 5% per jaar ondeskeidelik te verlaag. Die verhoging in verpligtinge wat as gevolg hiervan ontstaan het, is vanuit die surplus onder die fonds befonds.

Vroeg in 1993 het die Raad van Trustees 'n beleid aanvaar om te poog dat geen pensioentrekker se pensioen tot minder as 75% van oorspronklike koopkrag daal nie. Dit het dan ook tot die verhoging in die voorsiening vir pensioen verhogings op 1 January 1993 gelei.

Hierdie beleid het tot gevolg gehad dat 'n groot aantal pensioentrekkers wie se pensioenkoopkrag tot onder 75% gedaal het, oor die volgende aantal jare groot aanpassings gekry het.

Die aktuariële waarderingsverslae sedert 31 Desember 1989 het aangetoon dat daar in totaal meer pensioenverhogings toegestaan is as wat vanuit die beleggingsopbrengs op the bates van pensioentrekkers onder die fonds toegestaan kon word. Berekininge van die aktuaris het getoon dat, indien 'n aparte rekening ten opsigte van pensioentrekkers bedryf was, die rekening op 1 Julie 1997 in 'n tekort sou wees. Die befondsingsvlak op die datum sou nagenoeg 95% beloop wat beteken dat 'n deel van die surplus oor tyd ten opsigte van pensioentrekkers aangewend is aangesien die pensioen trekkerverpligtinge as ten volle befonds veronderstel was.

Berekininge van die aktuaris het verder getoon dat die koopkrag van alle pensioentrekkers minstens 75% van oorspronklike koopkrag was end dat the koopkrag ten opsigte van aftredes vanaf 1986 nagenoeg soos volg was:

1 Julie 1986

82%

1 Julie 1987	85%
1 Julie 1988	87%
1 Julie 1989	92%
1 Julie 1990	95%
1 Julie 1991	98%
1 Julie 1992	99%
1 Julie 1993	100%
1 Julie 1994	99%
1 Julie 1995	100%
1 Julie 1996	99%
1 Julie 1997	100%

Thus, Mr Mouton concludes that the pensioners have been more than fairly treated and the history of the fund reflects this.

16. As regards to the complainants' arguments in respect of the 10% increase in pensionable salary, Mr Mouton contends that this amendment took place in January 1994. This decision was made by the trustees in consultation with the participating employer in the fund. The reason for the amendment was to make the employer more competitive in the employment market.
17. The fund advanced no argument in respect of the complainants' second argument that the enhancement should be applied to the retirement benefit prior to commutation.
18. The out-sourcing of pensioners is regulated by section 14 of the Act. The relevant provisions of section 14 applicable in this matter, reads:
  1. No transaction involving the amalgamation of any business carried on by a registered fund with any business carried on by any other person (irrespective of whether that other person is or is not a registered fund), or the transfer of any business from a registered fund to any other person, or the transfer of any business from any other person to a registered fund shall be off any force or effect unless -

1. ...
2. ...
3. the registrar is satisfied that the scheme referred to in paragraph (a) is reasonable and equitable and accords full recognition -
  1. to the rights and reasonable benefit expectations of the persons concerned in terms of the rules of a fund concerned; and
  2. to any additional benefits the payment of which has become established practice,

and that the proposed transactions would not render any fund which is a party thereto and which will continue to exist if the proposed transaction is completed, unable to meet the requirements of this Act or to remain in a sound financial condition or, in the case of a fund which is not in a sound financial condition, to attain such a condition within a period of time deemed by the registrar to be satisfactory;...

Thus, the scheme (transfer of pensioners) has, *inter alia*, to be reasonable and equitable and recognise the rights and reasonable benefit expectations of persons concerned and any additional benefits the payment of which has become standard practice.

19. The board of management of any pension fund has a duty to distribute the surplus reasonably, in accordance with the rules of the fund and its duties set out in section 7C of the Act. The compelling duty in this matter is set out in section 7C(2)(a), which requires the board to take all reasonable steps to ensure that the interest of the members in terms of the rules of the fund and the provisions of the Act are protected at all times especially in the event of the transfer of a business as contemplated in section 14. Further, section 7C(2)(b), (c) and (d) require the board to act with due care, diligence, good faith and impartiality in respect of all members and beneficiaries.

20. The members, including pensioners do not *per se* have a right to share in the surplus. At the very best, they have a legitimate expectation that they may benefit from a surplus distribution.
21. The pensioners were out-sourced to Sanlam and Old Mutual on the same terms and conditions applicable in terms of the rules of the fund. They have received their defined benefits within the fund. There were lengthy negotiations between the fund and various pensioners before the surplus decision and distribution was made. Thus, the board before making the surplus distribution had clearly considered the interests of the pensioners. Their decision eventually granted the pensioners a share in the surplus in the form of an enhancement to their respective actuarial reserve values.
22. The issue for determination (and in essence the complainants' argument) is whether they are entitled to a greater share in the surplus.
23. Turning to the complainants' first argument whereby they request the enhancement of current employees actuarial reserve value (transferring to the defined contribution section) to be the same as that of the pensioners being out-sourced. This argument stems from the false premise that the two classes of persons (pensioners versus active members) share the same characteristics and therefore a uniform enhancement should be applied. The complainants are pensioners who have already retired and commuted one-third of their pension. Thus, they have in effect already received a portion of their defined benefit. Their remaining portion is a pension payable by the fund. On the other hand, active members have not yet received any benefits from the fund. Further, it is not certain what benefits (death, incapacity or dismissal) they would receive. Thus, these two classes are different and cannot simply be treated as the same.

24. The distinction between the two classes is further borne out by Mr Mouton's argument that as from 1997 all rental and interest income of the fund will be taxed by the South African Revenue Services. This new tax does not at all affect pensioners. However, it does indeed affect the active members of the fund, who have a proportionate share in these now taxable assets. The new tax means that active members have a greater risk or liability to counter. It is perfectly reasonable to use a portion of the surplus to act as a buffer against this new risk. Thus, I am of the view that pensioners and members cannot be merely lumped together and a uniform enhancement applied to their actuarial reserve values.
25. In any event the complainants' argument is flawed on the basis of what eventually transpired. Initially, the trustees agreed to grant a 15% enhancement. After lengthy negotiations between the various parties, this was increased to 20%. Due to an actuarial error the complainants' enhancements were closer to 30% and those who joined Sanlam enjoyed additional benefits. The complainants on the other hand elected to receive their pensions from Old Mutual. However, Old Mutual's cut-off date to qualify for the benefits of demutualisation was backdated to 31 December 1997. Accordingly, the complainants could not share in this benefit. The fund initially elected Sanlam as the only insurer to which pensioners could transfer. The complainants were dissatisfied with this choice and vigorously negotiated the choice of Old Mutual as an insurer. Thus, in many ways the complainants may be regarded as the architects of their own downfall.
26. I now turn to the complainants' second argument, in terms of which they contended their enhancement should be applied to their full retirement benefit prior to any commutation. Upon retirement, the complainants in terms of the retirement benefit rule, had an option to commute a portion of their pension (up to a maximum of one-third). They all elected to commute one-third of their pensions. Thus, in respect of this one-third, they received a portion of the defined benefit and have no further claims against the fund and by the same token the fund has no further liability

towards them. Accordingly, there is no basis in the rules of the fund, in law or otherwise why the enhancement should be applied to the actuarial reserve value including this commuted portion.

27. Turning to the third argument raised by the complainants that their pensions were not in line with inflation and the investment returns of the fund. The board of management has a duty to ensure that pensioners' benefits (monthly pension) are in line with the cost of living and inflation (see *Edge & Others v Pensions Ombudsman and another* [1999] 4 All ER 546 (CA) at 566J). In this matter, the trustees have complied with this duty. According to Mr Mouton, the pensions were not only in line with the investment return of the fund, but also increased in accordance with the prevailing inflation rate over the years (see paragraph 15).
28. Moreover, contrary to common belief, in a defined benefit fund there is no necessary connection between the investment return of the fund and the increases granted to pensioners (such a connection may exist in a defined contribution fund). That is, the complainants are entitled to their defined benefits, which in this case amounts to a commuted benefit plus a pension. Any increase may be factually dependent on the investment return of the fund, but in law there is no requirement that the rate of investment return be the rate of increase granted to pensioners. Taking this argument to its logical conclusion would mean that in the event of adverse market conditions and the fund suffering a negative rate of return, the pensions payable may be reduced or even the pensioner being required to pay the fund. Accordingly, there is no basis in the complainants' third argument allowing for a greater share in the surplus.
29. The complainants' fourth argument relates to an issue outside the surplus distribution. That is, the amendment of pensionable emoluments to include the basic salary enhanced by 10%, with effect from 1 March 1994. Since the complainants retired prior to this date they did not enjoy the benefit of the 10%

enhancement and they accordingly argued that this amounts to unfair discrimination.

30. The stated objective of this amendment was to make the employer more competitive in the employment market. There is nothing inherently wrong with this objective. I am of the view that the means used to achieve this objective are also proportional. The selection of 1 March 1994 as the effective date of the amendment is *prima facie* arbitrary without a proper rationale. It leads to the result that any member who joined the fund after this date will enjoy the benefit of a 10% enhancement, even though such a member's contribution to the build up of the surplus within the fund is minimal if not zero, yet he shares in the surplus. However, any cut-off date selected by the fund will create a differentiation amongst the members of a pension fund. This differentiation is not *ipso facto* unfair. The fund's decision to distribute the surplus invariably would have to be effective from a certain date and no matter which cut-off date was selected differentiation amongst members would result. The fact that the complainants retired prior to the effective date does not support a finding that they have been treated unfairly.
31. Thus, in summary, the complainants have been well treated and have not fared too badly. The trustees, in making their distribution in 1998, considered the interests of the pensioners and after negotiations between the various stakeholders decided to award them a 20% enhancement. Due to actuarial differences the enhancements eventually amounted closer to 30%. Had the complainants elected the option of Sanlam as an insurer they would have enjoyed the benefits of demutualisation and their respective enhancements in real terms would probably be the greater than 30%. Their respective transfer values were transferred to Old Mutual and due to circumstances beyond the control of the fund they did not enjoy the benefits of demutualisation. However, this was in line with their informed investment choice, which they elected without any undue influence or duress.

32. Accordingly, for the foregoing reasons the complaint is dismissed.

Dated at **CAPE TOWN** this 24<sup>th</sup> day of February 2000.

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**John Murphy**

Pension Funds Adjudicator