IN THE TRIBUNAL OF THE PENSION FUNDS ADJUDICATOR

CASE NO.:PFA/WE/141/98/IM

In the complaint between:

William Edward Linwood Dallas	Complainant

and

Standard Bank Group Retirement Fund	First Respondent
The Standard Bank of South Africa Limited	Second Respondent

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

Introduction

The complainant retired from the service of the second respondent on 30 September 1998 having completed 42 years of membership with the first respondent. He has lodged two separate complaints with my office and although they concern different issues, I have decided it is in the best interest of all the parties, and with their consent, to address both complaints concurrently in this determination.

The first complaint was lodged in September 1998 when the complainant was still employed by the second respondent, holding a managerial position, and concerns the question of ownership of the assets of the first respondent following its reorganisation in January 1995 from a defined benefit basis to a largely defined contribution basis, the "contribution holiday" subsequently taken by the second respondent as employer, and other related issues.

The second complaint was lodged in March 1999, after the complainant had retired, and concerns, among other things, the conditions being imposed by the first respondent prior to enabling the complainant to purchase a pension from the insurer of his choice in terms of its rules.

The complaints have been properly lodged with the respondents and then with this office in terms of section 30A of the Act, and at the request of my senior investigator, Mr Ian McDonald, a comprehensive response to the allegations was provided by the respondents satisfying the requirements of section 30F. I must compliment the parties concerned on the open and detailed nature of their submissions and the fullness of the supporting documentation provided. The issues and arguments emerge quite clearly and, therefore, in determining the matter, I have relied solely on the documentary evidence submitted, together with the report of my senior investigator Ian McDonald.

Background to the complaints

With effect from 1 January 1995 (the conversion date), the first respondent, which had previously been known as the Standard Bank Group Pension Fund, was converted from a defined benefit arrangement to a defined contribution arrangement with the proviso that those members who were members at the conversion date were given the choice, to be exercised only at the date the benefit became payable, of taking their benefit based on the defined benefit rules which applied prior to the date of conversion (the old rules), or on the basis of the re-vamped defined contribution rules that came into effect from the conversion date (the new rules). As a result of this proviso, the fund did not become a pure defined contribution arrangement in the true sense of the words in respect of existing members, but continues to have an underlying defined benefit guarantee which necessitates the continued provision of periodic valuation reports and financial solvency tests as required by the Act. In addition, the employer retains the responsibility to contribute amounts over and above the defined contribution rate specified in the rules, if required on the advice of the valuator, to ensure that the assets of the fund remain sufficient to meet its overall

liabilities, including those related to the guarantee. To facilitate this hybrid benefit structure, the assets of the fund as at the conversion date were divided up and are now held in three accounts known as the Share Account, the Pensions Account and the Reserve Account. The Share Account comprises the member shares of all current members and the Pensions Account contains the assets required to provide the required benefits to pensioners, deferred pensioners and their dependants. The balance of the assets of the fund are divided amongst the five sub-accounts that make up the Reserve Account, established to provide for contingencies and obligations of the fund not covered by the Share Account or the Pension Account. The opening balances of these accounts as at the conversion date, and their subsequent cash-flows, were determined in accordance with the rules of the fund, under the advice and supervision of the valuator.

With effect from 1 January 1996, the normal employer contribution rate was reduced from 10.5% of members' pensionable salaries to 7.5%.

Early in 1998, after the Financial Services Board had publicised its proposals regarding the possible repatriation of fund surpluses to sponsoring employers, discussions of an exploratory nature in this regard were held between the employer, the fund and various other interested parties.

In February 1998 the complainant, contemplating possible early retirement, enquired as to the benefits available to him in terms of the rules and at the same time requested a copy of the full audited accounts of the fund. In the fund's financial statements for the year ended 31 December 1996, which were subsequently sent to him, reference was made to the fact that an employer contribution holiday had been taken and that the valuator had certified that this would not render the fund financially unsound. This raised further questions in the mind of the complainant, which he raised in a letter to the fund dated 13 July 1998, and follow-up letters dated 21 July 1998 and 13 August 1998. The main thrust of these letters was to determine how the assets and investment earnings of the fund were distributed among the various accounts, and in particular the Reserve Account, with

specific reference to whether any portion of the reserves had been used to make good any shortfall arising as a result of the partial contribution holiday taken by the employer. They also sought advice on whether the employer intended to repatriate any surplus that existed in the fund, or had already done so, by way of the contribution holiday it had taken, where such surplus (if any) was being held in the fund, and what was to be done by the fund with any remaining surplus. The information was required in order to determine whether the employer and/or the fund were exceeding their powers in terms of the rules, and whether as a result, a formal complaint was warranted. As no satisfactory response was obtained from the fund or the employer, the complainant lodged his first complaint with my office on 29 September 1998.

In the meantime, in a letter dated 14 August 1998 the complainant had advised the respondents that he wished to retire with effect from 30 September 1998 and then in a letter dated 30 September 1998 that he wished to exercise his option in terms of rule 4.5(2) which states:

> (2) Instead of granting payment of a pension by the fund as contemplated in rule 4, the trustees may, at the request of the beneficiary, with the consent of the beneficiary's qualifying spouse and subject to any conditions which they may elect to invoke from time to time, agree to pay the whole or a part of the member's share that would have been applied by the fund towards such pension to an insurer to purchase a pension for the beneficiary concerned.

This option had been set out in a comprehensive letter from the first respondent dated 16 September 1998 in which all the options available to the complainant were explained and quantified, together with details of the first respondent's requirements of the complainant in order to effect his selected option.

The complainant completed an application to invest the balance of his member's share, after commutation of part thereof, with the insurer of his choice on 28 October 1998 and

this information was conveyed to the first respondent by his advisers, Standard Bank Financial Services. However, the next day he was advised telephonically that the application could not be acted upon until the first respondent had received from the complainant a formal waiver and indemnity, together with confirmation that the complainant's spouse had agreed to the purchase of a pension from an insurer. Both these conditions had been set out in the first respondent's letter of 16 September.

The complainant responded in a fax to the first respondent on 30 October 1998 giving reasons why he considered a waiver and indemnity should not be provided, and in their fax dated 2 November 1998 the first respondents confirmed that these were the conditions imposed by the trustees in terms of rule 4.5(2) as outlined above. In the meantime they agreed to pay the commutation amount requested by the complainant.

On 3 December 1998, the complainant again wrote to the first respondent enclosing a letter signed by his wife agreeing to the purchase of a pension from the insurer, and expanding on the reasons why he declined to complete the waiver and indemnity form. He went on to request the first respondent to transfer his member's share in terms of his request, and to add interest at the wholesale investment rate on both the commuted amount and the balance to be transferred, for the period from 1 October 1998 until the date of settlement in each case. In response to this letter the first respondent re-affirmed the trustees requirement that the complainant must sign the waiver and indemnity before his interest could be transferred to an insurer, adding that , if he was not prepared to sign the form, his interest would have to be used to purchase a pension from the first respondent. It also rejected the complainant's claim for interest at "the wholesale interest rate" explaining that since 1996 the trustees had ruled that interest on late payments would be at the same rate as the interim income distribution rate accrued on active members' share accounts, and the reasons for this.

Notwithstanding the contents of this last letter, in a letter dated 11 January 1999 the complainant enquired regarding the progress of the first respondent in respect of the

transfer of his member's share and the payment of interest at the wholesale investment rate. He also requested that the "Pensioners Card" that he had previously requested be forwarded to him. As no satisfactory response was obtained from the respondents, the complainant lodged his second complainant with my office on 25 March 1999.

The complaints

In each of his submissions the complainant addressed two areas of complaint, that is four complaints in all, which can be summarised as follows:

Complaint 1.1

The first complaint against the first respondent is that the respondent has failed to respond to requests for information, to the extent that it has not been possible for the complainant to evaluate,

(a) whether funds held in the fund's Reserve Account are justified;
(b) whether a contribution holiday taken by the employer is justified;
(c) whether any portion of the reserves, including excess/surplus assets in the fund have been used to make good a contribution holiday taken by the employer;
(d) the quantum of funds which are alleged to be in excess/surplus; and
(e) who has a claim to any portion of the excess/surplus assets or funds.

Complaint 1.2

The first complaint against the second respondent concerns apparent differences between the salary total package and benefit options agreed between the complainant and the

second respondent in November 1996, and the actual amounts being paid by the second respondent as employer towards retirement funding and medical aid since the contribution holiday became effective. The complainant avers that:-

> Notwithstanding that SBSA had from 1 January 1996 to date, taken a holiday in which it reduced its contributions to SBGRF from10.5% to 7.5%, it continued to deduct contributions at the rate of 10.5% from Managers Total Package.

In the first complaint the complainant raises 38 issues relevant to the complaint, referring to 26 documentary annexures and requests relief on 11 points.

Complaint 2.1

The second complaint against the first respondent is that the respondent has

(a) Declined to release the two thirds balance of the complainant's share account in the fund, which was advised as an amount of R993,248.00, to an external insurer, namely Standard Bank Financial Services (Pty) Ltd (SBFS), as instructed by the complainant in accordance with his rights in terms of the options in the rules of the fund.

(b) Insisted that the complainant provide the fund with a waiver and indemnity before agreeing to release the funds.

(c) Refused to pay interest to the complainant on the amount of R993,248.00 which was due on 1 October 1998.

(d) Refused to pay interest on the amount of R496,624.00, which was the commutable one third portion of the complainant's share account as advised by the funds management, which was due for payment on 1 October 1998, and the net proceeds of which were released by the fund on 2 November 1998 when it was credited to a banking account in the name of the complainant.

Complaint 2.2

A further complaint against the first respondent and or alternatively against the second respondent is that they have declined to provide the complainant with all the benefits normally accorded pensioners of SBSA which includes providing a Pensioners Card to enable the complainant to have proof of his status, and obtain any financial benefits offered to pensioners.

In the second complaint the complainant raises 6 issues relevant to the complaint, referring to 23 documentary annexures and requests relief on 8 points.

As mentioned previously the submissions by both the complainant and the respondents addressed the issues in great detail, and I feel that nothing would be gained by repeating the arguments and counter arguments here. Each party has been given a full copy of all the submissions of the other parties and has been given ample opportunity to comment on them. In what follows therefore, I will limit my comments to brief summaries of the issues that I feel are material and significant to the conclusions I have reached in my determination.

The determination

Complaint 1.1

In their response to the first complaint, the respondents have provided considerable additional information and comment which , if read together with the rules of the fund and other relevant documents in the hands of the complainant, answers the questions raised in the first complaint against the first respondent, satisfactorily.

The issue appears to have arisen from an initial seed of concern in the mind of the complainant, a long-serving member of a large well established pension fund, planted by

the content of various media reports of alleged mismanagement of funds, with particular reference to so-called “surplus” and “contribution holidays”. Two terms which mean vastly different things to different people and which have succeeded in conjuring up unreasonable spectres in the minds of experts and lay members of pension funds alike. Added to this the fund had recently converted from a defined benefit to a defined contribution basis. Perhaps adding more cause for concern, in the eyes of a long-standing member approaching retirement. In these circumstances, therefore, the complainant, in his own words, undertook a scrutiny as to how his fund had been managed over the past few years. Instead of alleviating his concerns the complainant’s initial investigations only served to add to his concerns as he could not rationalise in his own mind the very complex workings of the fund that he uncovered, to the extent that he became convinced that something had to be wrong. But he could not say what.

The problem lies in the fact that this is indeed, by normal standards, a very complex arrangement. Complex in that it has adopted a very intricate method of separating its assets into a number of specifically identified pools, each with a different purpose and controls, which collectively contribute to the provision of what is, in fact, a fairly simple benefit structure. The reason for this is presumably to avoid the necessity to run two separate funds, a defined benefit fund for “old” members and a defined contribution fund for “new” members, and it achieves this, while also allowing existing members to defer their choice of option till the time when each member’s benefit actually falls due. A more common approach is to require existing members to elect to stay with the “old” or move to the “new” with effect from a fixed conversion or transfer date, and then to make this election irrevocable.

The consequence of the first respondent’s approach is that it remains an on-going defined benefit fund, and will do so until the last “existing” member has exercised his or her option, and the last remaining benefit payable in terms of the “old rules” expires. Until then, the fund continues to require periodic actuarial valuations and to maintain contingency reserves to meet future liabilities and guarantees. Equally from time to time the fund may

experience "surpluses" and "shortfalls" depending on the relationship between actual experience (including market fluctuations) and the assumptions made by the valuator in his valuation process.

It is clear, therefore, that, referring to the summary of complaints above:

(a) the funds held in the various reserve accounts are justified in terms of the valuator's assessment of the various short and long term liabilities of the fund.

(b) subject to the fund meeting its liabilities to beneficiaries in terms of the rules, and the employer meeting its contribution requirements to the extent of these liabilities, as required by the valuator, there is no reason why the employer's contribution rate should not vary, up or down, from time to time, as the case may be. If a reduction in employer's contribution is interpreted as a "contribution holiday" in these circumstances then it is perfectly justifiable, provided it has the support of the valuator and meets the requirements of the Registrar, the Act and the rules.

(c) the amount of any "surplus" or "excess reserve" at any point in time differs according to actual past experience and the assumptions as to possible future experience made by the valuator. It can, therefore, vary considerably and can be positive or negative depending on the assumption made. One of the variables is the rate of employer contribution and if this is reduced it will have an effect on the results of the valuation. But it may have no effect on benefits if, for example, there is a compensating effect from some other assumption, such as the rate of investment return. It is not, therefore, appropriate to look at any one of these factors in isolation or to place too much emphasis on the value of "surplus" at any given point in time, in an ongoing fund. Such "snap-shot" views can be very misleading. The important issue is that the valuator must be comfortable that the fund will be able to meet all of its liabilities in terms of its rules, and the Act, as and when they arise.

(d) any excess or surplus assets that do emerge in an ongoing fund cannot be said to be finite

and are a product of the valuation basis. If they exist at all, in real terms, then they must be dealt with in accordance with the rules of the fund and in terms of the Act, neither of which currently permit repatriation to the second respondent.

Complaint 1.2

The first complaint against the second respondent concerns, on the one hand, a contractual agreement between the second respondent and the complainant as employer and employee respectively, and on the other hand, the obligations on the part of the second respondent to make contributions to the first respondent, in terms of its rules. The complainant points out that although his remuneration package indicates an allocation in respect of company contributions to the retirement fund which equates to 10.5% of his pensionable remuneration, the actual amount contributed by the second respondent since 1 January 1996 was 7.5% of his pensionable remuneration, as a result of the contribution holiday taken during that period. The complainant considers, therefore, that this amounts to a breach in terms of the contract.

It is common practice in industry and commerce for companies to refer to comparative income surveys in setting remuneration levels. These surveys are based on the total package or cost to the company of employing an individual. The package is broken down into its constituent components which express, among other things, the value of the employer's contribution towards retirement funding as a percentage of overall membership remuneration. In effect, the package agreement reflects that practice and not an intention to earmark a specific portion of the aggregated contributions for exclusive investment on behalf of the specific member. The contract has to be read in conjunction with the rules of the fund and the surrounding circumstances. The employer agrees to fund a portion of the cost of membership. The rules determine the benefits. Only in the case of a pure defined contribution arrangement where all the benefits provided are quantified in terms of fixed contributions could the contribution rates reflected in the package agreement be expected to exactly mirror the actual employer contribution in respect of each individual member. It is more normal for defined contribution arrangements to also include some element of defined

benefit, say in the event of death or disability, where cross subsidisation exists and the employer's cost is averaged across the membership pool.

In this particular case we have, as mentioned previously, a combination of defined contribution and defined benefit related benefits. Rule 8.2(1) says that the employer will be required to contribute an amount equal to each member's contribution (6.75% of pensionable emoluments) towards the provision of retirement benefits, and an amount as advised by the valuator from time to time that may be necessary to procure risk benefits and to cover the cost of expenses, taking due cognisance of the amount in the risk reserve account at the time. Rule 8.2(4) also makes provision for these employer contributions to be financed by way of special transfers from the employer reserve, where appropriate. It follows, therefore, that the complainants benefit expectations are unaffected by the fact that the employer's actual contribution rate has been reduced to 7.5% of pensionable emoluments as the balance of the cost is being met from within the fund, in terms of its rules. In addition it is clear that the true cost of risk benefits will differ from member to member, and in the case of the complainant will be considerably higher than average due to his age. However, this fact is not reflected in his remuneration package for the reasons outlined above.

In conclusion then, in terms of the pension fund, the complainant's benefit expectations are not prejudiced by the fact of the contribution holiday and it is not necessary that the employer's actual contribution on his behalf should equal the averaged employer contribution rate taken into account in determining his remuneration package.

The amounts reflected in the remuneration package as being allocated to medical aid and the actual amounts being contributed in this respect may or may not be correct in terms of the contract. However, this matter does not relate to the administration of the pension fund, the investment of the fund's assets or the interpretation and application of the fund's rules. The complaint relates to rights derived from the contract of employment. Accordingly this mater does not fall within the definition of a complaint in section 1 of the

Pension Funds Act of 1956 and I have no jurisdiction to pronounce upon its merits.

For the reasons given above, the complainant's first complaint is dismissed.

Complaint 2.1

From the summary of events leading up to the second complaint outlined above, it is clear that stalemate has been reached, and this is probably due to the growing gulf between the parties brought about by the issues raised in the first complaint. The first respondent feels that it cannot release the complainant's assets to a third party, over which it has no control, without the security of a formal waiver and indemnity ensuring that it will not be called upon again in the future to meet any further liability. The complainant, on the other hand, feels that by signing such a waiver and indemnity he would be giving up his constitutional rights and absolving the fund trustees from performing their fiduciary duties.

In terms of rule 4.5(2) quoted above, the trustees may agree to a transfer and they have the right to impose any conditions they feel necessary before agreeing to transfer the member's share to an insurer. The question then is, are the conditions being imposed by the fund in this case appropriate and reasonable, or would they, in fact, unduly prejudice the complainant.

The question as to whether the liability of a fund is fully absolved by the purchase of a promised or similar benefit from a third party is one that has troubled the industry for some considerable time. More recently, opinion has been moving to the view that the purchase of a pension in terms of its rules constitutes the full and final payment of the benefit due and absolves the fund of any further liability. Also, in terms of its General Note 18 issued in August 1996, the SA Revenue Service agrees that a fund may terminate its continued liability in respect of a retiring member once an annuity has been purchased in the name of the member from a registered insurer. This, however, does not necessarily absolve the fund from all liability in terms of the Pension Funds Act. As recently as May of this year

the Financial Services Board issued its Pension Fund Circular No. 100 which attempts to resolve the situation by setting out the terms and conditions under which such a purchase of benefit and resultant transfer of liability can be effected without the need for a certificate in terms of section 14 of the Act. However, the Registrar concludes his circular by saying;

> In confirming the above, the Registrar is aware that there is uncertainty as to whether such purchases of annuities will, in practice, relieve the fund of all liability towards the member. A court may decide otherwise. In order to put the issue beyond doubt, the Registrar is drafting a change to the Pension Funds Act to exclude this sort of transaction from the scope of section 14.

So, in the light of the above it remains the responsibility of the fund to take whatever action it feels necessary to protect itself and its remaining members from the consequences of any potential future claim from a member whose benefit has been purchased elsewhere. We must remember that the fund is under no obligation to allow the benefits to be purchased elsewhere. The benefit promised in terms of the rules is secure and can be paid from the fund accordingly. The complainant must, therefore, feel that he will gain some personal advantage by purchasing elsewhere. And with such advantage it would not be unreasonable to assume that there may be some additional investment risk, which should then fall on the shoulders of the complainant. It would surely not be reasonable to expect the fund to accept this additional risk.

In times of high inflation and high equity growth such as we have been witnessing in South Africa, there is a tendency for retiring members of pension funds to seek new ways to protect the purchasing power of their pensions. There has been a proliferation of new products which claim to achieve this, but unfortunately the higher the potential gain from these products, the greater the downside potential in times of market correction. There are many examples of pensioners who have been unable to recover financially from the effects of recent market downturns. So, if the complainant wishes to venture into a relatively higher gain, higher risk scenario he must first be comfortable with the price he has to pay. In such circumstances it seems reasonable to expect a transferring member to be prepared to cut his ties with the fund and accept the full liability to protect his own

and his dependants' future income by providing the fund with the waiver and indemnity it requires to protect the interests of its remaining members. He cannot expect to be able to fall back on the fund for support should his own investment decisions prove to be less than satisfactory. Accordingly, the imposition of the condition requiring a waiver and indemnity prior to transfer is reasonable.

Complaint 2.2

The complaint concerning the provision of a pensioners card does not relate to the administration of the pension fund, the investment of the fund's assets or the interpretation and application of the fund's rules. The complaint relates to a normal practice of the employer in terms of its contracts of employment. Accordingly, this matter does not fall within the definition of a complaint in section 1 of the Pension Funds Act of 1956 and I have no jurisdiction to pronounce upon its merits.

For the reasons outlined above, the second complaint is dismissed.

In all his complaints the complainant has requested that I grant an order against the respondents for his costs incurred in the complaint, and in their submissions the respondents have suggested that in the circumstances the claimant should not only pay his own costs but could, in fact, be expected to pay the costs of the respondents.

It is my considered opinion that the issues involved in these complaints, numerous though they may be, could have been resolved satisfactorily in discussion and negotiation between rational people, and should never have reached my office. They are, however, indicative of a rather unhealthy trend. There appears to be a growing number of instances where funds are falling seriously short of their obligations to resolve disputes internally, and members (particularly those fortunate enough to have the time and the resources to do so) are creating or protracting disputes unnecessarily, simply because they see my office as an easy and cheap way to score points against each other, in public. As a result,

my office, which is already overloaded far beyond the scope of its meagre resources, has even less time to concentrate on the genuine complaints that require speedy resolution on behalf of less fortunate members of our society. The purpose for which this office was established in the first place.

It would not, I feel, be fair to single out the parties to this particular complaint without prior warning, but I wish to make it known, publicly, that in future I will not hesitate to make an order against respondents and/or complainants to the extent of the costs incurred by my office, where I feel that a complaint has been lodged with me unnecessarily without appropriate endeavours having been made by the parties concerned to resolve the dispute internally.

DATED at CAPE TOWN this 22nd day of JULY 1999.

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John Murphy
Pension Funds Adjudicator