

IN THE TRIBUNAL OF THE PENSION FUNDS ADJUDICATOR

CASE NO: PFA/NW/30/58/53/99/NJ

In the complaint between:

BW Senekal

First Complainant

TJ Smith

Second Complainant

JM Koekemoer

Third Complainant

and

Municipal Gratuity Fund

Respondent

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

- 1. These are complaints lodged with the Pension Funds Adjudicator in terms of section 30A(3) of the Pension Funds Act 24 of 1956 (hereinafter referred to as "the Act"). The complaint relates to a decision by the respondent not to award the complainants the benefits of demutualisation of Sanlam received by the fund. The complainants seek an order directing the fund to award them their respective proportionate shares in the demutualisation benefits.**
2. Since all of the complaints require the determination of substantially the same questions of law and fact, it is convenient to consolidate the complaints and to proceed with them as one complaint. All parties were in agreement that I should exercise my powers in terms of section 30J(1) of the Act to follow this procedure.

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3. No hearing was held in this matter. An investigation was conducted by my investigator, Naleen Jeram. Accordingly, in determining this matter I have relied exclusively on the documentary evidence, written submissions and additional information obtained during a series of telephonic conversations, all gathered during the course of Mr Jeram's investigation.
4. The complainants are Mr Johannes Mattheus Koekemoer, Mr Thomas Johannes Smith and Mr Bartel Wilhelmus Senekal, a group of retirees, who all retired from the respondent during 1998 and are currently residing in the North West Province.
5. The fund is Municipal Employees Gratuity Fund, a pension fund duly registered under the Act (hereinafter referred to as "the fund"). The fund is represented by Mrs A Roodman and Mr Dewald Jacobson, the principal officer of the fund.
6. The fund is a defined contribution fund and commenced on 1 January 1994. The fund is controlled and administered by a management committee appointed in terms of rule 8. In terms of rule 29 the assets of the fund are held in 2 accounts, namely, the share account and the reserve account. Each account is maintained separately and transfer between the accounts may only take place as specified in the rules.
7. Rule 30 sets out the composition of the respective accounts and reads:

30. SHARE AND RESERVE ACCOUNTS

1. Share Account

The Share Account shall comprise the total of all the individual Members' Shares. Each Member's Share shall comprise:

(1) Credits

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- (1) An opening balance comprising the MEMBER'S TRANSFER VALUE as at the COMMENCEMENT DATE;
- (2) the MEMBER'S CONTRIBUTIONS in terms of section 26;
- (3) a portion of the LOCAL AUTHORITY'S CONTRIBUTIONS in respect of the MEMBER in terms of section 31(1)(b), determined by the COMMITTEE in consultation with the ACTUARY, towards the provision of retirement benefits;
- (4) transfer values received in respect of a MEMBER in terms of section 42;
- (5) investment earnings transferred from the Reserve Account in terms of section 30(2) from time to time at a rate to be determined by the COMMITTEE in consultation with the ACTUARY. Such investment earnings shall be based on the investment yield achieved by the FUND during the period for which the said earnings are credited to the MEMBER'S Share Account;
- (6) *ad hoc*-bonuses from the Reserve Account as determined by the ACTUARY based upon distributable valuation profits in terms of section

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23(2).

(2) Debits

- (1) Attributable valuation losses as determined by the ACTUARY in terms of section 23(2);
- (2) retirement values paid to the MEMBER in terms of section 32;
- (3) withdrawal payments in terms of section 34;
- (4) transfers to the Reserve Account of any balance on the Member's Share on termination in terms of sections 34 and 35.

2. Reserve Account

The Reserve Account is established to provide for contingencies and obligations of the FUND not covered by the Share Account and comprises a record of all moneys of the FUND not allocated to that account. The following transactions shall be recorded in this account:

(1) Credits

- (1) a portion of the LOCAL AUTHORITY'S CONTRIBUTIONS in respect of the MEMBER in terms of section 31(1)(b), determined by the

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COMMITTEE in consultation with the ACTUARY, towards the death, disability and funeral benefits and the cost of the administration expenses;

- (2) all investment earnings earned by the FUND;
- (3) valuation losses debited to the Share Account in terms of section 30(1)(b)(i);
- (4) any reinsurance payments made to the FUND by an INSURER in terms of section 33(2)(a);
- (5) transfers from the Share Account in terms of section 30(1)(b)(iv).

(2) Debits

- (1) Lump sum death and disability benefits in terms of sections 33 and 35(4);
- (2) all costs and expenses referred to in section 19(2);
- (3) any premiums in respect of reinsurance in terms of section 33(2) and (4);
- (4) transfers to the Share account in terms of section 30(1)(a)(v) and (vi);

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- (5) any other payments by the FUND not authorised elsewhere in the Rules.

 - (3) The Reserve Account comprises some or all of the following components, each of which is to be determined by the ACTUARY:
 - (1) An investment reserve to absorb fluctuations in the market value of the FUND'S investments;
 - (2) a risk reserve to absorb the impact of an adverse experience in risk benefits not reinsured in terms of section 33(2);
 - (3) a contingency reserve to absorb strains caused by erroneous data and other unforeseen contingencies;
 - (4) unallocated surpluses.
8. In accordance with rule 30, there was a separation of members' share accounts and the reserve account and any profits or losses arising from the assets of the fund were allocated to the reserve account. The benefits/losses arising from the fund's performance was allocated to the members by way of declaration of bonuses. The fund declared an interim bonus rate and a final bonus rate. The interim bonus was a monthly bonus given in advance based on the estimated final growth rate for any given year. The final growth rate was actuarially calculated after the closing of the financial year and finalisation of the actuarial valuation. Hence, if a positive interim bonus rate was declared, this amount was immediately credited to the member share account by means of a transfer from the reserve account.

9. In January 1998, for the first 9 months of the year, the management committee declared an interim bonus rate of 1% for each month. Thus, the fund credit as at 31 August 1998 of all members of the fund who were employed by the local authority on 1 September 1998 was increased incrementally by 9%. However, in August/September 1998 the financial markets all around the world, including the Johannesburg Stock Exchange “crashed” resulting in a severe negative financial impact on the fund. On 18 September 1998, the management committee of the fund decided that the fund credit as at 31 August 1998 of all members be decreased by 9% and an interim bonus rate of 0% be maintained until further notice except for members who retired at the age of 65 between September 1998 and December 1998, whose final benefits were not debited by 9%. Accordingly, the complainants’ respective fund credits were reduced by 9%.

10. Mr Smith, Mr Koekemoer and Mr Senekal took early retirement from service prior to reaching the age of 65 and respectively received their benefits computed in terms of the early retirement rule. Their respective retirement dates were 30 October 1998, 30 November 1998 and 30 November 1998. The relevant rule regulating their early retirement was rule 32, which reads:

32. RETIREMENT

- (1) When a MEMBER reaches the NORMAL RETIREMENT DATE, he shall retire from the permanent service of the LOCAL AUTHORITY and such retirement shall take effect from the first day of the month immediately after the month in which he reaches the NORMAL RETIREMENT DATE: Provided that he may, by mutual agreement between himself and the LOCAL AUTHORITY, be retained in the service of such LOCAL AUTHORITY on a yearly basis up to the age of sixty five years.

- (2) Notwithstanding the provisions of subsection (1), a MEMBER who has attained an age of fifty years, shall have the right to retire.
- (3) ...
- (4) On his retirement, a MEMBER will become entitled to a lump sum equal to his FUND CREDIT. Notwithstanding the provisions of subsection (5) hereof, no INTEREST will be payable on any additional amounts payable as a result of the deletion of the scaling down of benefits in respect of retirement after the age of fifty five years to MEMBERS who retired prior to 1 August 1996.
- (5) ...

Fund credit for each member is defined as the balance in his share account as contemplated in rule 30(1), which in turn refers to the member's share (see paragraph 7).

11. The complainants' benefits were composed as follows by the fund:

JM Koekemoer

Lid se oordragwaarde	:	R 778,255.00
Lid se surplus waarde		R 141,968.00
Lid se bydraes		R 20,339.64
Raad se bydraes		R 33,830.12
Bonusse		R 45,966.59
Beleggings		<u>R 134,652.12</u>
Totaal		<u>R1,155,011.47</u>
TJ Smith		

Lid se oordragwaarde	R 574,797.00
Lid se Addisionele Waarde	R 99,456.00
Lid se surplus waarde	R 235,666.00
Lid se bydraes	R 43,960.98
Raad se Bydraes	R 66,304.54
Bonusse	R 39,409.36
Beleggings	<u>R 459,281.75</u>
Totaal	<u>R1,518,875.63</u>

BW Senekal

Lid se oordragwaarde	R 430,836.00
Lid se addisionele waarde	R 80,792.00
Lid se surplus waarde	R 176,642.00
Lid se bydraes	R 47,459.31
Raad se bydraes	R 71,915.66
Bonusse	R 133,179.29
Beleggings	<u>R 252,098.33</u>
Totaal	<u>R1,192,922.59</u>

Because they retired between October and December 1998 and before reaching the age of 65, the complainants' benefits did not include any investment return for the year 1998.

12. The demutualisation of Sanlam occurred on 1 December 1998. Any policy holder registered with Sanlam on 31 March 1998 qualified for the issue of free Sanlam shares. The fund qualified for the allocation of free shares. The number of shares received were 2,122,350. Capitalised at R6 per share (December 1998) the full value of the benefit received by the fund was R127,340,000.
13. As a result of this windfall, the fund was in a position to declare a final bonus rate of 2.5% for the 1998 calendar year. On 3 February 1999, the management committee decided **that**

the proceeds of demutualisation shall not be paid directly to members or ex-members, but rather be treated as a normal investment return of the fund and dealt with in accordance with the rules (the reasons for this decision shall appear fully below).

14. Since the complainants were not members of the fund at February 1999 (when the final rate was declared) they did not enjoy the benefit of the 2.5% final bonus rate and hence did not share in the proceeds of demutualisation. The complainants were dissatisfied with the decision.
15. The complainants strongly argued that the proportionate share of the benefits of demutualisation should be passed over to them. They contended that they were members of the fund as at 31 March 1998, the cut-off date to qualify for free shares and therefore should share in the benefit. They further argued that the final bonus rate of 2.5% should be proportionately awarded (in respect of membership for the year 1998) to them.
16. Mrs Roodman, acting on behalf of the fund, raised the following arguments as to why the complainants were excluded from the benefits of demutualisation. Firstly, the management committee decided not to award the proceeds of demutualisation directly to members or former members but rather to treat it as a normal investment return of the fund. The benefits of members in a defined contribution fund varies from time to time depending on the movement in the financial markets, and thus all profits (arising out of the purchase or sale of shares, interest from fixed deposits, rental and fixed property or allocation of shares in terms of demutualisation) are distributed to the members by way of interim and final bonuses. Therefore, the fund's argument in essence is that demutualisation shares are effectively merely another source of income enhancing the financial position of the fund contributing to the declaration of bonuses and it is not viable to treat these shares differently to other sources of income such as dividends received on shares or interest received on bonds etc..

17. Mrs Roodman further argued that the use of the interim/final bonus rate system ensured equity amongst members especially in regard to members who left during the year. That is, if interim bonuses were not granted, members who left the fund before declaration of the final bonus would have received no return on their benefits for that year or part thereof. The fund always endeavoured to keep the interim monthly bonus rate as close as possible to the real growth for the year thereby ensuring that members who left during the year would then have received a return close to the real growth. She concluded that it is standard custom in the industry to give final bonuses only to existing members as it is only a top-up from the interim bonus and since the complainants left the fund and were no longer members of the fund at the time of the declaration of the final rate they did not qualify for the 2.5% investment return. She further justified their exclusion by arguing that all existing members continued to carry the risk of downward trends in the market as opposed to the complainants who left the fund at a certain point and carried no further market risks.
18. Had it not been for the benefits of demutualisation the final bonus rate declared would have been much lower and closer to 1.5%. Thus, the argument appears to be (although not expressly stated) that the benefits of demutualisation were used as a buffer against the poor investment performance of the fund during 1998.
19. Mrs Roodman also referred to Pension Fund Circular 104 ("PFC 104"), in support of the fund's case. PFC 104 reads:

UTILISATION BY RETIREMENT FUNDS OF THE FREE SHARES ACQUIRED THROUGH DEMUTUALISATION

Following the issue of free shares by the Old Mutual and Sanlam as a result of their

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demutualisation, some retirement fund boards of management are apparently contemplating passing these shares, or the cash obtained from sale of the shares, directly to the members of the funds.

The Registrar wishes to draw the attention of boards of management to the following:

1. The free shares have been obtained as a result of the investment of the fund's assets, or the placement of insurance, with a mutual society which has demutualised. The free shares belong to the fund.
2. Members and pensioners have no entitlement to free shares allocated to the fund.
3. The value of the free shares increases the value of the fund's investments. The board of management determines how this additional value should be applied. They could improve benefits. They could reduce contributions. They could use the additional value to subsidise future costs.

In whatever way they choose to utilise the additional value, the board of management must exercise their fiduciary duties towards all the stakeholders in the fund, and the board of management must work within the powers given to them in terms of the rules. After deciding how they want to use the additional value, the board of management must, therefore, check that the rules allow them to use the monies in this way. If the rules do not permit their desired action, the board of management should seek an amendment of the rules and only apply the additional value once the Registrar, and any other party which might be required to approve rule changes before they are valid, have approved the amendment.

4. A fund can only pay benefits.

Members only become entitled to a benefit when they leave employment. The board of management cannot, therefore, pass the free shares to active members, or pay them money in lieu of such shares, or reduce housing loans made by the fund to members.

Similarly, the board of management cannot reduce any loans made to the employer.

5. The board of management may apply some of the additional value for the benefit of pensioners and of former members.

In the case of pensioners, existing pensions can be increased or the appropriate amount could be paid out as a lump sum, or some combination of the two, provided the rules permit such payments. In the case of former members who have already been paid a benefit, the additional amount can be paid out as an addition to the benefit previously paid. Any such amount paid out will be taxed.

In the case of former members who transferred to another retirement fund, the appropriate addition to their transfer value should be paid across after application in terms of Circular PF101 for a certificate in terms of section 14 of the Pension Funds Act.

20. Mrs Roodman concluded that the complainants have been fairly treated and no further benefits were due to them. Accordingly, she requested the complaint to be dismissed.
21. From the evidence presented to me and the further investigation conducted by my investigator, I believe that there are three key issues for determination in this matter.

Firstly, whether the complainants are entitled to a final bonus rate of 2.5% for the 1998 calendar year. Secondly, whether the decision by the committee to treat benefits of demutualisation as normal investment returns, thereby effectively excluding former members is a legitimate and rational one. Thirdly, whether the decision by the committee not to debit accounts of all persons who attained the age of 65 years and retired between September 1998 and December 1998 was in accordance with the rules of the fund and the committee's fiduciary duties. I deal with the issues in turn.

22. Regarding the question of the final bonus rate declared by the fund and whether the complainants are entitled to the 2.5% for their proportionate period of membership in the 1998 calendar year. The power of the fund to pass on the fund's investment returns or the proceeds of demutualisation is contained in its power to credit and debit certain accounts as strictly regulated by rule 30.
23. The interim bonus rate of 1% declared for the first 9 months of 1998, may be credited to the members' share (accounts) in terms of rule 30(1)(a)(v) whereby the investment earnings of the fund may be transferred from the reserve account to the member's share account at a rate determined by the actuary of the fund. The declaration of a negative 9%(reversal) and accordingly debiting the member's account is also in accordance with rule 30(1)(b)(i) in terms of which "attributable valuation losses as determined by the actuary..." may be debited against a member's account. The final bonus rate of 2.5% is also regulated by rule 30(1)(a)(v), in terms of which "...such investment earnings shall be based on the investment yield achieved by the fund during the period for which the said earnings are credited to the member's share account."
24. Thus, in order to qualify for a credit to a member's share account, one must be a member of the fund. In terms of rule 24, any person who leaves the service of the local authority (the participating employer in the fund) shall cease to be a member. Thus, the complainants by virtue of retiring from service and receiving their early retirement benefits in 1998 ceased to

be members of the fund. Therefore, in terms of rule 30(1)(a)(v) it is not possible for the fund to credit them with the final bonus rate of 2.5%. Before the fund could pass on the benefits of demutualisation to former members, it would be necessary to amend the rules to acquire that power which it currently does not enjoy.

25. Whenever the committee exercises a power granted to it in terms of the rules of the fund, it must do so in accordance with its fiduciary duties. PFC 104 issued by the Registrar correctly indicates that members have no automatic right to the benefits of demutualisation. The board of any pension fund has a discretion in determining how to distribute the benefits which must not be contrary to the rules of the fund. That discretion is required to be exercised properly, and in this case, as explained, would have to be preceded by a rule amendment.

26. In terms of section 7C of the Act, the board of management has a duty to act with impartiality in respect of all members and beneficiaries. The extent and scope of this duty and the basis upon which a court may interfere with the board's decision upon the breach of this duty was fully examined by the Court of Appeal in the United Kingdom in the recent case of *Edge & Others v Pensions Ombudsman and another* [1999] 4 All ER 546 (CA).

There it was stated:

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.

27. The court normally will only interfere if the decision maker considered an irrelevant factor

or ignored a relevant consideration or fettered its discretion on one way or the other. Moreover, the court will not interfere on the basis of the weight attached to each factor. In this regard the judge in the Court of Appeal stated:

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 (my emphasis).

28. The management committee in this instance considered a series of factors before deciding to treat the shares as a normal investment return. Due to poor market conditions the fund had a very low investment return for the calendar year 1998. The benefits of demutualisation were in effect used as a buffer against the poor market conditions by increasing the final rate of return to 2.5%. Being a defined contribution fund, the complainants after leaving the fund did not bear the risk of the market forces. Further, former members had enjoyed good investment returns from the fund in the preceding years as is reflected in the complainants' final benefits. On the strength of these considerations the fund decided to retain the proceeds in the fund and in effect distribute them to existing members.
29. In accordance with the *Edge* decision, I am of the view that the committee have properly taken into account all relevant considerations and ignored irrelevant factors. Further, they have not fettered their discretion in any way. As with the Court of Appeal in *Edge* I am disinclined to look at the weight attached to each factor in this case. Such a decision lies with the management committee who are in the best position to properly and fully evaluate the wide range of competing interests involved in the distribution. Since the decision was properly and rationally arrived at there is no basis in law or otherwise to interfere with that decision.
30. Turning to the decision not to debit the accounts of members who retired at the age of 65 during September to December 1998 with 9%, (that is, not to reverse the interim bonus rate of members retiring at normal retirement age). According to Mr Jacobson, the primary reason was not to punish retirees. These members having attained the age of 65 years could

no longer remain in the fund. Whereas the complainants had the option of not retiring from service and remaining a member of the fund. For the same reasons stated above, I am reluctant to interfere with this decision. The reasons advanced by the fund, the rules of the fund, the overall investment return of the fund for the 1998 calendar year and the generous benefits received by the complainants, (from a tax point of view and overall performance of the fund over the years) are relevant considerations which have been fully canvassed and considered by the committee. The decision is neither illegitimate nor irrational.

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

Dated at CAPE TOWN this 14th day of March 2000.

John Murphy
Pension Funds Adjudicator