IN THE TRIBUNAL OF THE PENSION FUNDS ADJUDICATOR

CASE NO: PFA/GA/448/98/IM

In the complaint between:

KEITH LOBER **Complainant**

and

SOUTH AFRICAN EAGLE PENSION FUND **Respondent**

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

Introduction

1. This complaint concerns the amount of withdrawal benefit paid to the complainant by the respondent in terms of its rules on his resignation from the service of South African Eagle Insurance Company Limited ("the company").

2. The issues involved are relatively straightforward and emerge clearly from the written submissions of the parties. I am satisfied that the parties have had ample opportunity to comment and that the provisions of section 30F of the Act have been complied with.

3. Having considered the written submissions of the parties, together with the report of my senior investigator Ian McDonald, I have determined the complaint as follows. These are my reasons.

Background to the complaint

4. The complainant became a member of the respondent on becoming eligible in September 1992, and contributed in terms of the rules until withdrawing at the end of July 1998.

5. For the period from his date of joining till 31 December 1993 the complainant contributed directly to the fund at the rate of only R200 per month, being the discretionary limit placed on member contributions by the Trustees in terms of the then rule 15 concerning member contributions, which said:

> Every member shall contribute to the Fund 6.7% of his pensionable emoluments; provided that he shall not contribute in any month more than such amount as the trustees decide from time to time. His contributions shall be deducted by his employer from his salary or wages and paid immediately to the fund.

6. It should be noted here, however, that the employer was required to contribute the amount of the shortfall between 6.7% of pensionable emoluments and the amount of contribution actually paid by members, in addition to the normal employer contribution rate determined by the trustees in consultation with the actuary, in terms of rule 18, as follows:

> (1) Each employer shall contribute to the fund amounts equal to such percentage of the total pensionable emoluments of all members as determined by the trustees after consulting the actuary. The employer's contributions shall be paid to the fund at the same time as the corresponding contributions deducted from the salaries or wages of the members.
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> (ii Each employer shall also pay to the fund the amount by which a member's contributions are less than 6.7% of his pensionable emoluments.

7. In December 1993 a memorandum was circulated by the respondent to all its members announcing various proposed changes to the benefits and contributions, including:

> Contributions remain at 6.7% of salary but the limitation of a maximum contribution is removed. The full 6.7% is thus now deductable from your salary and is also deductable under the Income Tax Act. The company will be communicating separately and individually with those employees affected by this change.

8. This change became effective from 1 January 1994 and would have had a significant effect on the take home pay of many members, so, in an attempt to reduce these effects, the employer agreed to increase the salaries of all affected employees by an amount which took cognisance of the increased contribution.

9. The complainant resigned from the company with effect from 31 July 1998 and on 21 July 1998 was given a memorandum from the respondent indicating the amount of his withdrawal benefit, which accumulated all the contributions he had actually paid to the fund. This included R200.00 per month for that first period of service to 31 December 1993.

10. Benefits in the event of resignation are set out in rule 31 which, in respect of a member such as the complainant, states that if the member resigns voluntarily from the service,

> ...he shall be entitled to a benefit equal to his Accumulated Contributions.

"Accumulated Contributions" is defined as the sum of:

> (ii the total of his contributions, and
>
> (ii 4% of that total for each complete year of the period for which he has paid contributions to the fund and a previous scheme.

"Contributions" is defined as:

> For a member, the amounts paid or payable by him to the fund and to a previous scheme exclusive of interest, excluding any such contributions that have been refunded to him.

11. In an internal memorandum dated 27 July 1998 addressed to Mr B Holt, General Manager,

Human Resources and copied to Mr P T Martin, Chairman, Pension Fund, the complainant queried the amount of interest on his contributions that had been included in the withdrawal benefit, as follows:

> Following my resignation from SA Eagle, I am required to withdraw from the SA Eagle Pension Fund with effect from 31 July 1998. As discussed on Friday 24 July 1998, in determining my withdrawal benefit, I noticed that I have only been paid 20% (4% times 5 years) interest on my contributions, even though I have 5 years 11 months service with the company, and also have a months leave due to me. I therefore believe that I should be paid out for 6 years service, or alternatively, the 11 months service should be pro-rated to determine the interest for my withdrawal benefit, as in effect, I will be getting no interest on these 11 months contributions. In addition, it should be noted that the interest paid on the withdrawal benefit is also much less than the actual return of more than 19% pa compound over the past 5 years.
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> If necessary, I trust that this matter will be discussed with the Pension Fund Trustees at the meeting to be held on 28 July 1998, so that it can be finalised before I leave.

12. In a subsequent memorandum to the same parties on 29 July 1998 the complainant again queried the calculation of his withdrawal benefit, specifically in relation to the rate of contributions paid during his initial period of membership, saying:

> Having reviewed the calculation of my total contributions to the pension fund during my period of service, 1/09/92 to 31/07/98, I believe that it has been incorrectly calculated. According to my calculations, my total contributions to the fund (before the 4% interest factor), being 6.7% of my pensionable emoluments in terms of rule 15 of the South African Eagle Pension Fund, amounts to R83,735.96 (as per the attached calculation), whereas the calculation provided to me only shows contributions of R72,260.33, a shortfall of R11,475.63. It appears that the reason for this difference is that my contributions for the period 1/09/92 to 31 12/93 have only been determined as R200 per month, being the amount deducted from my salary each month. However, according to my understanding at the time I joined SA Eagle, the difference between the R200 and the 6.7% of my pensionable salary was being paid by the company on my behalf by way of salary sacrifice so that my total member contribution to the fund was still 6.7% in terms of rule 15 of the

> fund. This is borne out by the fact that my gross salary was increased by 6.7% in January 1994 when it was decided that the full 6.7% members contribution to the fund would be shown as a deduction from salary rather than a salary sacrifice. I therefore believe that my total contributions, being the 6.7% of my pensionable salary, during the period 1/09/92 to 31/12/93 should also be refunded to me on withdrawal from the fund.

13. On 4 August 1998 Mr Holt responded with the following:

> I have discussed the first two memo's with the Trustees and also independently with the chairman to whom I understand you have also written.
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> The calculations have been done strictly in accordance with the rules and as such must stand. The rules allow for the "Accumulated Contributions" to be the sum of "the total of his contributions". Leave due has no impact on those calculations. The members contribution is the sum of contributions actually paid by him and as you correctly say were a lesser amount than 6.7% in the earlier years. There is no reference to a salary sacrifice, rather the scheme operated as a partial -contributory scheme in those days. When the change was made to a fully contributory scheme in 1994, the company elected to increase salaries to offset the burden of increased contributions and the effect on taxation. Previously only the actual contributions paid were allowable for tax calculation purposes.

The complaint

14. The complainant avers that the rules of the fund have been applied incorrectly by the respondent in the calculation of his withdrawal benefit to his detriment and in addition that the rules governing withdrawal benefits are inequitable and unconstitutional.

15. He argues that the rate of interest payable on member contributions is very low considering that the fund earned in excess of 20% compound over this period. In addition, the fact that the interest factor is based on complete years of contributory membership resulted in no interest being paid in respect of his last eleven months membership.

16. Regarding the amount of contributions payable in the initial period of his membership, he

claims that the balance of contributions due in terms of the rules over and above the R200 per month actually deducted from his salary was a form of salary sacrifice made available to him in view of his position as Assistant General Manager. As a result his **effective** rate of contribution was in fact 6.7% of pensionable salary throughout his membership.

The response of the respondent

17. In his response on behalf of the respondent, Mr Holt in his capacity as Principal Officer opens with the following statement.

> The SA Eagle Pension Fund is a defined benefit fund and the benefits are clearly defined in its rules. It is required to act in terms of its rules and while the Trustees have some discretionary power the circumstances would have to be exceptional for them to act inconsistently with the rules. The calculations which have given rise to Mr Lober's complaint have been made strictly in accordance with the rules of the Fund and this does not appear to be in dispute. Mr Lober does not allege a violation of either the rules of the fund or the Pension Funds Act but rather (it would appear to me) bases his complaint on the notion that for the reasons he enumerates the rules should be applied differently and more favourably to him than is the intention for all members of the fund. In specific they are the rules as relate to Service, Interest and Employees contributions. The Rules do not give the fund this flexibility and I (in my capacity as guardian of the employer's people policies) would not subscribe to the Fund having that right nor of the Trustees interpreting their discretion as including that right. It is thus in this context that I respond to Mr Lober's allegations.

18. He goes on to make the point that the rules provide for interest to be calculated at a rate and for a period of service. Service is determined as a specific calendar period for the purpose of calculating benefits, and it would not, in his opinion, be equitable to base the interest on the rate being earned by the fund at the time of withdrawal, as this would benefit those who withdraw during the good years while prejudicing those who withdraw in the lean years.

19. He challenges the accuracy of the complainant's interpretation of accumulated contributions as contained in the rules and applied in determining withdrawal benefits, saying, among

other things:

> It should also be noted that the definition of "accumulated funds" refers to "**his contributions**" and that lower down on the same page these are defined as "***...the amounts paid or payable by him...***". Mr Lober also attaches and correctly refers to Rules 15 and 18 however, it must also be noted that his reference to Rule 15 is only partial and that he has omitted the portion of the sentence which reads "**...provided that he shall not contribute in any month more than such amount as the Trustees decide from time to time...**". This amount was determined by the Trustees during 1992 and 1993 as being R200 and is the amount referred to by Mr Lober in his submission. This limitation existed almost from the inception of the fund and was increased from time to time by the Trustees.
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> Rule 18(2) under the heading "**Employers Contributions**" makes it clear that the excess over the R200 is payable by the company and is considered to form part of the employers contributions and not the member's.
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> The limitation on the payment of contributions was not in any way linked to the position held by any employee and was applied to all members of the fund irrespective of their level in the organisation. It could be said that at that time the fund was a partially contributory (or partially non contributory) fund in respect of any employee earning in excess of R2,985 (R200 / 6.7%)....
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> ...At no time has the impression been given that this contribution by the employer has ever been considered to belong to the employee. I have no record of Mr Lober ever raising this issue either on his own behalf or on behalf of those persons who reported to him and joined or left us during his term of office. I am also not aware of Mr Lober ever questioning the amount reflected on his annual IRP5 thereby contending that these payments belonged to him. As the company's Investment Manager Mr Lober attended meetings of the Trustees and had many opportunities to raise the issue in that forum - at no stage did he ever do so.

The issues for determination

20. It is not what the rules say that is at issue in this case, but rather how they have been interpreted and applied, and whether they are, in fact, fair and reasonable.

21. Although I would have difficulty agreeing with the respondent's comments on the effects of applying a fund's rate of return earned for the purpose of calculating withdrawal benefits, it is true to say that a fund is under no obligation to pay this to a withdrawing member. In a defined benefit arrangement withdrawal benefits are one of the benefits that are defined in the rules and need not necessarily relate to factual experience in any way. Once defined they are then accounted for in determining the overall cost of the arrangement, and the contributions required by members and their employer. Having said that, they must also, of course, stand up to the scrutiny to which all fund rules are subjected as regards their constitutionality and reasonableness. They must be set out in a manner which enables the members to know in advance what their benefit entitlements are. They should not be open to different interpretation in different circumstances by different generations of trustees.

22. Rule 31 which specifies benefits payable on resignation covers numerous circumstances not relevant to this case, which I will ignore. The part that relates to the complainant, as previously referred to in 10 above, simply states,

> ...he shall be entitled to a benefit equal to his Accumulated Contributions...

23. In the definitions "Accumulated Contributions" is defined as the sum of:

> (i) The total of his contributions; and
> (ii) 4% of that total for each complete year of the period for which he has paid contributions to the fund and a previous scheme.

and "Contributions" is defined as:

> For a member, the amounts paid or payable by him to the fund and to a previous scheme exclusive of interest, excluding any such contributions that have been refunded to him.

24. Although it cannot be said to be over generous, the use of a formula such as "4% times the

number of years membership" in arriving at a factor by which to increase member contributions to provide a "reasonable" withdrawal benefit is not uncommon. It is often referred to as the "simple interest" method, but in fact bears no relationship to interest whatsoever. It is merely a means of arriving at a factor based on the number of years service completed, by which to increase the known amount that the member has contributed, in order to determine the value of the withdrawal benefit. A member who leaves after 5 years, as did the complainant, will have the return of his own contributions increased by 20%, after 10 years 40%, after 25 years 100% and so on. It is clear, its is precise, it is non-discriminatory, and it is not unreasonable.

The fact that only completed years of service are used in the formula is probably intended for reasons of simplicity, and, as mentioned above, has no real bearing on the matter. Taking months into account would only serve to smooth out the progression of the table of factors.

25. The other element in the equation is "contributions", the definition of which is included in 22 above, and which is then carried through to the main body of the rules where it is expanded upon in rule 15 which quantifies member's contributions as shown in 5 and 6 above.

26. What is and is not member contributions for the purpose of calculating a withdrawal benefit is determined by cross-reference to all these different definitions and rules, and is at the centre of the major part of the dispute before me. It therefore requires some careful analysis.

27. The respondent claims that the rules clearly state that a member's contributions relate only to those amounts paid **by him** and are limited to the extent that "...he shall not contribute in any month more than such amount as the trustees decide from time to time...". In other words the R200 per month for the period used in calculating the withdrawal benefit.

28. The complainant, on the other hand, argues that, according to his understanding, the difference between R200 and 6.7% of his pensionable salary was in fact a salary sacrifice, so that his total contribution to the fund was still 6.7%. This understanding is borne out, he claims, by the fact that his gross salary was increased by 6.7% in January 1994 from which date the full 6.7% would be deducted from his salary rather than as a salary sacrifice. In effect his net income position remained the same before and after the change.

29. The issues that surround various forms of remuneration packages that one comes across are between employer and employee and rarely have a direct bearing on the pension fund. They do not fall within my jurisdiction as Pension Funds Adjudicator and I must, therefore, look to the rules of the fund themselves for a solution.

Whether the company and the complainant had in fact agreed on a salary sacrifice is of no consequence, unless the rules in question take account of the fact in determining a benefit, or are written in such a way that they can, in the eyes of a reasonable member be interpreted to do so. To repeat my comment in 20 above, the rules of a defined benefit fund must be set out in such a manner that enables the members to know in advance, what their benefit entitlements are.

30. The definition of "contributions" refers to amounts "paid or payable by him to the fund". If only the amounts actually paid directly to the fund by the member are to qualify, then it would not have been necessary to add the words "or payable". The use of these words implies reference to amounts "payable" by the member in terms of the rules but actually "paid" by some other party.

31. Returning now to rule 15 at the time in question, it is clearly stated that every member shall contribute to the fund 6.7% of his pensionable emoluments with the proviso that he will not contribute in any month more than such amount as decided from time to time by the

trustees.

It is difficult to understand the purpose of stating a fixed contribution level and then allowing it to be infinitely variable in terms of a proviso. The purpose is certainly not clear from the rules, but it would not be unreasonable to assume that it is there to allow the trustees, perhaps on behalf of the company, to adjust the amounts contributed by different groups of members and/or at different periods of time, with some other purpose in mind.

At the very least it indicates a degree of discrimination between members, if only in that lower paid members appear to be contributing a relatively high percentage of their earnings, and vice versa, unless such contributions are being deducted in some other way, and all members are, in fact, contributing at 6.7% of their pensionable emoluments.

32. Reference to these contributions being added to the normal employer contributions in rule 18(2) also intrigues me. I see no purpose in separating these contributions out, when the employer is required, in any event, to pay the balance of cost of the benefits, as determined by the actuary. Surely there must be a reason, and again it seems reasonable to assume that it may relate to an original intention for these to be separately identifiable in the fund's records. But for what purpose, if it was not to enable the fund to take them into account when calculating benefits. It could surely not have been intended for the purpose of identifying how much the company had "saved" as a result of a member's early withdrawal.

33. Mr Holt argues in his submission that rules are rules and they must be applied strictly as they are written. I would not disagree with this approach, provided the rule wordings, and the intentions they convey, are clear, easily interpreted and understood. Members have a right to be able to determine from the rules, not only what their ultimate benefit entitlements will be, but also they must be able to quantify how much they will have to contribute to secure these benefits, for the duration of their membership. It is not possible for members of this fund to do so by reference to the original wording of rule 15, unless they assume a contribution of 6.7% of pensionable emoluments as being the norm throughout.

It is apparent that the company and the fund also found it advisable to remove the proviso from rule 15 in terms of its amendment effective 1 January 1994, and to adjust member's salary packages accordingly, so that from that date members could readily identify the amount of their contributions.

34. It is my conclusion, therefore, that the complainant's contributions to the respondent were, in fact, 6.7% of his pensionable emoluments throughout his membership, regardless of how his actual salary was determined each month. As a result the respondent should have included this amount in full in the calculation of his withdrawal benefit in terms of the definition of "accumulated contributions". Other factors applied in the calculation of accumulated contributions are neither unreasonable nor unconstitutional, as suggested by the complainant.

35. The order of this tribunal is as follows:

35.1 The respondent shall recalculate the amount of withdrawal benefit due to the complainant, taking into account contributions by him at the rate of 6.7% of his pensionable emoluments throughout his membership of the fund.

35.2 The balance of the withdrawal benefit so calculated over the amount already paid on behalf of the complainant shall be paid by the respondent to or on behalf of the complainant in the same manner as the previous amount was paid, together with interest for the period from 1 February 1999 (six months after the date of leaving service, in terms of rule 31.) to the date of actual payment, at the rate of growth actually experienced by the fund during that period.

35.3 Such payment shall be made no later than 6 weeks after the date of this determination.

Dated at **CAPE TOWN** this **29th** day of **OCTOBER 1999.**

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John Murphy
Pension Funds Adjudicator