

IN THE TRIBUNAL OF THE PENSION FUNDS ADJUDICATOR

CASE NO: **PFA/GA/1024/99/KM**

In the complaint between:

GLEN SPEAR

Complainant

and

IBM SA 1994 PROVIDENT FUND

First Respondent

IBM SA (PTY) LTD

Second Respondent

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

1. This is a complaint brought in terms of section 30A of the Pension Funds Act 24 of 1956 hereafter referred to as the “Act” concerning the computation of his pension benefit on termination of his membership of first respondent.
2. Complainant is Glen Spear, a former member of the first respondent and a former employee of second respondent.
3. First respondent is IBM S A 1994 Provident Fund (hereafter referred to as the “IBM provident fund”), a provident fund duly registered under the Act.
4. Second respondent is IBM SA (Pty) Ltd, a wholly owned subsidiary of International Business Machines Corporation of the United States of America (hereafter referred to as IBM). As will appear from the circumstances set out below, IBM has not until now been a party to these proceedings, although it is clear that it has some interest in the subject matter of this determination. For that reason I deem it advisable to join IBM as the second respondent in these proceedings, and to proceed by way of a preliminary determination. This will

afford IBM the opportunity to make submissions for consideration in the formulation of a final determination in this matter.

5. The complainant acts for himself in this matter and the first respondent is represented by Deneys Reitz Attorneys. The second respondent, on account of the circumstances outlined above, is as yet unrepresented.
6. The first respondent has requested that a hearing be held in this matter by virtue of the complexity of the issues involved. In view of the nature of this dispute, which is essentially one of law, and bearing in mind that the present determination is of a preliminary nature, I am not persuaded that a hearing will be of any assistance at this stage. However, I am certainly prepared to entertain such a suggestion in the event that further submissions are filed and in circumstances where it would be useful in the final disposition of this matter.
7. An investigation under my supervision was conducted by my senior investigator, Karin Mackenzie. Accordingly, in determining this matter, I have relied exclusively on the documentary evidence and written submissions gathered during the course of our investigations.
8. The complainant seeks an order directing the trustees of the IBM provident fund to transfer a portion of the members' reserve account to the Penlink Portfolio Provident Fund (hereafter called the "Penlink provident fund") to which the complainant was transferred pursuant to a Section 14 transfer of business scheme under the Act.
9. The complaint essentially amounts to an allegation that the complainant, together with several other transferred members of the IBM provident fund, will be prejudiced to the advantage of the remaining members of the IBM provident fund, who will have the exclusive benefit of a reserve account should a proportionate amount not be transferred to the newly established fund, the Penlink Provident Fund.

10. The factual background to this matter is concisely set out in the response filed by the first respondent's attorneys, the salient facts of which are not disputed by the complainant.
11. The complainant is an information technology sales representative who has worked for IBM South Africa for nearly 25 years.
12. Prior to 1994 employees of IBM were members of a defined benefit pension fund, the IBM Pension Fund. With effect from 1 March 1994 the employees were given the option of moving to the IBM provident fund, a defined contribution fund. In respect of each member who elected to transfer, an amount representing his actuarial value was credited to his fund credit in the new IBM provident fund, without any enhancement of value. From the surplus in the IBM pension fund, an amount representing 25% of the aggregate actuarial reserve value of the transferring members was transferred to the IBM provident fund and credited to a reserve account (Reserve account no 1) to be used for fund expenses and benefit increases. A further amount was also transferred from the surplus in the IBM pension fund to a second reserve account (reserve account no 2) for the exclusive benefit of the employer.
13. The rules regulating the establishment of the two reserve accounts in the IBM provident fund read as follows:

4.3 Reserve Accounts

Two reserve accounts to be known as Reserve Account No. 1 and Reserve Account no. 2 shall be maintained under the Fund and shall operate in accordance with Rule 4.4 and Rule 4.5.

4.4 Reserve Account No.1

4.4.1 To Reserve Account No. 1 shall be credited

- (a) that part (if any) of the Employer's Portion in respect of a Member to which the Member is not entitled on leaving Service; and

- (b) any amount required to be credited in terms of Rule 13.1.8

4.4.2 The amount standing to the credit of the Reserve Account No. 1 shall be increased by

- (a) the share of the net yield on the Fund's investments that the amount in the Reserve Account No. 1 bears to the sum of all amounts standing to the credit of the Fund; and

- (b) any interest earned by the Fund which is not applied under the Fund Credit.

4.4.3 The amount standing to the credit of the Reserve Account No. 1 shall be used:

- (a) towards meeting the Fund's expenses to the extent to which these expenses are not met by the contributions paid in terms of Rule 4.2.2;
- (b) where so decided by the Trustees, to meet all or part of a deficit referred to in Rule 4.2.3 or for a purpose referred to in Rule 17.8;
- (c) as decided by the Trustees, in consultation with the Actuary, to increase benefits payable by the Fund; provided that the amount referred to in Rule 4.4.1(b) plus the appropriate share of the interest earned by this amount, shall be applied for this purpose at the sole discretion of the Principal Employer.

4.5 Reserve Account No.2

4.5.1 To Reserve Account No. 2 shall be credited the amount referred to in Rule 13.1.9

4.5.2 The amount standing to the credit of Reserve Account No. 2 shall be invested in assets separate from those in which the rest of the Fund's assets are invested and the net yields of the assets in which Reserve Account No. 2 is invested shall be credited to Reserve Account No. 2

4.5.3 From the amount standing to the credit of Reserve Account No.2 from time to time such amounts may be deducted each month as are required to meet some or all of the Employer's contributions in terms of Rule 4.2.1.

14. Moreover, rules 13.1.8 and 13.1.9 were enacted at the same time that rule 4 was amended with effect from 1 March 1994. They read as follows:

13.1.8 The Trustees shall have power to take transfer of such other amount transferred from the Previous Fund as the trustees of the Previous Fund may allow as an opening balance in terms of Rule 4.4.1(b).

13.1.9 The Trustees shall have the power to take transfer of such other amounts transferred from the Previous Fund as calculated by the actuary of the Previous Fund to be a proportionate share of the assets of the Previous Fund that are in excess of each individual's transfer value, and any amounts transferred in terms of Rule 13.1.8, which shall be credited to the Reserve Account No. 2.

15. Rules 4.2.2 and 4.2.3 referred to in rule 4.4.3 above which govern the application of the funds standing to the credit of reserve account no1 read as follows:

4.2.2 Out of the amount paid in terms of Rule 4.2.1

(i) such amounts as are required to meet the Fund's expenses for the month concerned and the death benefit referred to in Rule 6.1(a), will be applied for this purpose;

and

(ii) the balance will be applied towards the Member's retirement benefit

4.2.3 If the contribution made by the Employer in terms of Rule 4.2.1 is at any time insufficient to meet the cost of the death benefit referred to in Rule 6.1(a), the Trustees may decide that the deficit shall be met by drawing all or part of the amount required to meet the deficit from the Reserve Account. Otherwise, the benefit will be reduced to the proportion for which the cost has been paid.

16. Rule 17.8 referred to in rule 4.4.3(b) provides:

17.8 Subject to the consent of the Revenue Authorities, the Principal Employer, in consultation with the Trustees, will have the right to grant a Member a greater benefit

than that provided for elsewhere in these Rules. The cost of the benefit will, as the Principal Employer and the Trustees agree

(a) be met by an additional contribution by the Employer;

or

(b) be met from the Reserve Account;

or

(c) be met partly by an additional contribution by the Employer and partly from the Reserve Account.

17. In its response the first respondent explains the basis on which the members' credits and the amount credited to the first reserve account were transferred:

"In 1994 approximately 1400 members, including Spear transferred from the Pension Fund to the Provident Fund. The members actuarial values in the Pension Fund were credited to their personal accounts in the Provident Fund. In 1995 a further 71 members transferred from the Pension Fund to the Provident Fund on the same basis. It was agreed between the Trustees of the Pension Fund, the Trustees of the Provident Fund and the Company that an amount equal to 25% of the transferring members actuarial reserve would be transferred from the surplus in the Pension Fund to the Provident Fund as a reserve. In 1994 R53 226 769.00 was transferred from the Pension Fund to Reserve Account 1 of the Provident Fund. In 1995 a further R4 830 858.00 was so transferred in respect of that year's transferees. The total transferred was therefore R58 057 627.00."

18. The import of the above is the following:

- At the time of the transfer of members from the IBM pension fund to the IBM provident fund each transferring member took with him to the IBM provident fund a transfer credit consisting of his actuarial value in the IBM pension fund, but was not directly credited with an additional surplus enhancement.
- However, a portion of the surplus in the IBM pension fund was transferred to reserve account no1 in the IBM provident fund. The amount was arrived at by

calculating 25% of the aggregate actuarial reserve values of the transferring members. The intention in creating this account was clearly to benefit the members by creating a reserve to insulate them from the investment risks inherent in a defined contribution scheme, and historically (as shall appear below) it has been used for precisely this purpose.

- A second amount was transferred from the surplus in the IBM pension fund to reserve account no 2. In terms of rule 4.5.3 this account is for the employer's exclusive benefit as a vehicle for a contribution holiday, with its assets being invested separately under rule 4.5.2. In a detailed response from the first respondent the only reference to this account is the following:

"By an amendment to the Rules of the fund a second investment reserve account was created (*"Reserve Account No 2"*); but the moneys standing to its credit have been all but exhausted in defraying the expenses for which the rules governing the account make provision, and this account can, accordingly, be ignored for the purposes of this case."

I cannot agree with this conclusion, as will become apparent for the reasons set out below. Nor have I been furnished with an accounting of the transfers in and out of the account.

19. Over the following few years reserve account no 1 was augmented by investment returns and profits consequent on early withdrawals by members of the fund. It was also depleted by certain distributions predominantly in favour of the individual fund members in respect of years in which they received low or negative returns due to poor investment performance. These credits to individual accounts, which are termed "investment boosters" by the first respondent add up to an amount in excess of R38 000 000. The amount standing to the credit of reserve account no 1 as at the end of 1999 was R51 912 183.
20. In 1999 the complainant was forced to transfer out of the IBM provident fund as a result of the sale of the division in which he was employed. In terms of an agreement dated 7 September 1998 International Business Machines Corporation

sold its Network Connectivity Business worldwide to AT&T Corporation. Pursuant to this agreement, the complainant left the employ of IBM and commenced employment with AT&T on 1 September 1999. He transferred along with certain other members of the IBM provident fund to the newly established Penlink provident fund.

21. The transfer of business to the Penlink provident fund fell within the provisions of section 14 of the Act and the Registrar issued a certificate in terms of section 14 approving the transfer from the IBM provident fund to the Penlink provident fund.
22. Pursuant to the complainant's transfer, his full fund credit was transferred from the IBM provident fund to the Penlink provident fund with effect from 1 September 1999, as was the case with the other employees who left IBM and joined AT&T. No part of reserve account no.1 was added to their transfer values.
23. Complainant's case is that he is entitled to a transfer from the IBM provident fund to the Penlink provident fund of some portion of reserve account no.1 in the former. He contends that there should be a reserve in the new fund which will provide a buffer against the vagaries of investment performance. Alternatively he claims that he should benefit from a distribution from the reserve in the form of a once-off payment in proportion to his interest in the reserve account.
24. The first respondent's legal representatives raise several defences to this complaint.
25. As a preliminary point it is contended that despite inferences to the contrary in the complainant's papers he has no *locus standi* to act for other members of the IBM Provident Fund who may have been similarly prejudiced. Indeed, the complainant has not adduced any evidence of formal entitlement to act on their behalf. However, such does not preclude the complainant from seeking relief on his own behalf.

26. It is also alleged that a transfer cannot be impugned if it has been sanctioned by the Registrar under Section 14 of the Act, and that the transfer in the present case has been so sanctioned. In essence this amounts to a contention that this tribunal has no jurisdiction to consider complaints that seek relief which, if granted, would vary the terms of a transfer which has already been endorsed by the Registrar of Pensions. There is no merit in this contention; the Supreme Court of Appeal has expressed itself on the issue in the *Tek* case as follows:

“It seems advisable to deal with a particular contention advanced by Appellants which may surface again if there is further litigation in the dispute. It was that the Registrar’s approval in terms of section 14(1) of the Pension Funds Act of what was done when the provident fund was created and some of the assets of the pension fund were transferred to it precludes the Court from entertaining Respondent’s claims unless the Registrar’s certificate given pursuant to section 14(1)(e) is set aside on review. I do not agree. The Registrar’s certificate is predicated upon an *intra vires* and properly taken decision by the trustees of the fund. If the decision of the trustees is open to attack because it is *ultra vires* or because it has not been properly arrived at, the Registrar’s certificate cannot save it.”

27. The substantive defences of the respondent can be summarized as follows:

- Any enquiry into a decision of the trustees cannot be based on broad principles of equitable jurisdiction, but must be confined to an investigation of whether the member obtained his rightful benefit under the fund rules; in terms of the rules the complainant received his correct benefit;
- Even though section 14 may by implication entitle the complainant to a transfer value that is reasonable and equitable, the trustees’ decision cannot be criticized as falling short of the requirements of reasonableness and fairness in the present circumstances;
- The bulk of the funds in reserve account no.1 fall under the control of the employer (IBM) which has not exercised its discretion in this regard, and consequently the trustees have no power to direct that a portion of the

reserve account be transferred in favour of the complainant or any other members in the same situation as the complainant.

28. The complainant's benefit entitlements flow from two sources:

- the rules of the IBM provident fund, and
- the statutory protection afforded him by virtue of the provisions contained in Section 14 of the Act.

29. Turning to the rules of the fund, one finds that transfer benefits are provided for in rule 9.2, which reads as follows:

"Transfers out of the Fund

If a member is transferred to the service of a company or other organisation associated or subsidiary to the Employer but not participating in the Fund, then

- (a) if the transferred member becomes a member of an Approved Provident Fund or an Approved Pension Fund established for the benefit of the employees of the organisation to which he is transferred, the Trustees will pay the Member's Fund Credit at the date of his transfer to that fund and he will have no further claim on the Fund; or
- (b) if the circumstances provided for in (a) do not exist, the Trustees, in consultation with the Principal Employer and the Actuary, will decide on the manner of dealing with the Member's Fund Credit."

30. It seems that this rule does not provide for the present situation, where the member is transferred to a division or organisation which is neither associated with nor subsidiary to the Employer.

31. Rule 7.1 regulates the benefit entitlements of a member who resigns or is dismissed, and rule 7.2 provides for the benefit entitlements in the case of redundancy. They read as follows:

7.1 Resignation or Dismissal

If a member who is not qualified to retire in terms of rule 5 leaves Service of his own free will or is dismissed by his Employer for reasons other than those provided for in Rule 7.2, he will become entitled to a lump sum benefit equal to:-

- (a) his Member's Portion at the date of leaving Service; plus
- (b) the following percentage of the Employer's Portion at the date of leaving Service:-

Years of Continuous Service	Percentage
1	20
2	40
3	60
4	80
5 or more	100

For the purposes of the above table, "Years of Continuous Service" means the period during which the Member was a Member of the Fund increased by the period (if any) ranking as pensionable service which he had completed in terms of the rules of the Previous Fund.

7.2 Redundancy or Retrenchment

If a member who is not qualified to retire in terms of Rule 5 leaves the Service as the result of his having been declared redundant or having been retrenched, then he will become entitled to his Fund Credit at the date of leaving service.

32. "Fund Credit" is defined in the rules as follows:

"Fund Credit" means for each Member at any particular date the sum of :-

(a) his Member's Portion;

and

(b) his Employer's Portion

33. "Member's Portion" is defined as

"Member's Portion" means in relation to each Member at any particular date the accumulated value of

(a) his contributions (if any) made in terms of Rule 4.1 and (if applicable) transferred to the Fund in terms of Rule 9.1.1; and

(b) the Member's Transfer Credit (if any);

together with interest thereon at a rate declared by the Trustees on the advice of the Actuary.

34. "Employer's Portion" is defined as follows

"Employer's Portion" means an amount equal to the sum of

(a) a future service benefit equal to the accumulated value of that part of the contributions made by the Employer in respect of the Member in terms of Rule 4.2 which is applied in terms of Rule 4.2.2(ii) and which does not form part of the Member's Portion together with interest thereon throughout his membership of the Fund at the same rate as that applied to the Member's Portion;

and in the case of a member who was a member of the Previous Fund and who transfers the benefit to which he is entitled under that Fund to the Fund,

(b) (i) a past service benefit calculated by the Previous Fund at the date of transfer into the Fund, by the Actuary to the Previous Fund on actuarial principles which take into account, inter alia, the Member's pensionable service, pensionable salary and accumulated contributions under the Previous Fund on the day before the transfer;

- (ii) such benefit being reduced at the date of its transfer into the Fund by the amount which constitutes the Member's portion on withdrawal from membership of the fund concerned at that date; and
 - (iii) such reduced benefit being increased throughout his membership of the Fund at the same rate as that applied to the Member's Portion.
- 35. It seems that the present situation (a transfer of fund members pursuant to a sale of a division of the employer to an organisation other than an associated entity or subsidiary company) has not been specifically catered for in the rules. It is clear that the complainant did not resign, but given his transfer to AT&T on operational requirement grounds it is perhaps appropriate to consider his transfer as a "retrenchment".
- 36. However, it is common cause that at the time that the complainant left the employ of IBM his full fund credit was transferred from the IBM provident Fund to the Penlink provident fund. This was the most favourable benefit that he would have been entitled to under any of the above categories.
- 37. In addition to the standard benefits, however, there are two mechanisms in the rules which allow for increased benefits to be paid. The first is contained in rule 17.8 which empowers the employer, in consultation with the actuary, to grant a greater benefit to an individual member to be met from reserve account no.1 or by the employer, or a combination thereof. The second occurs in the amended rule 4.4.3 (c) which provides for the Trustees, in consultation with the actuary, to apply funds standing to the credit of the reserve account to increase benefits payable to members.
- 38. Besides their entitlements under the rules, members who are transferred to other funds in terms of section 14 have additional statutory rights by virtue of the duties imposed on boards and employers by the requirements of the section. Section 14(1)(c) requires the Registrar to be satisfied that the scheme is reasonable and equitable and affords full recognition to the rights and reasonable benefit expectations of the members concerned. It must also accord full recognition to

any additional benefits, the payment of which has become established practice. Thus, as the natural corollary of the requirements set out in section 14 for certification by the Registrar of a transfer scheme, the board (and where appropriate the employer) has a duty to ensure these requirements are met.

39. In assessing the reasonable benefit expectations of the members it would be proper to have regard to the remarks by the Supreme Court of Appeal in *Tek Corporation Provident Fund and others v Lorentz* [2000] 3 BPLR 227 (SCA), where Marais JA at paragraph 47 states:

In so doing account would have to be taken of s 14(1)(c) of the Pension Funds Act, which deprives a transfer of any force unless the Registrar is satisfied, *inter alia*, that the scheme 'accords full recognition to the rights and reasonable benefit expectations of the persons concerned in terms of the rules of a fund concerned'. What is comprehended by the expression 'reasonable benefit expectations' is not easy to say. Plainly it must mean something over and above the defined benefits to which the persons mentioned are entitled.

It is this interpretation, that reasonable benefit expectations relate to expectations and benefits above and beyond the defined benefits, which the complainant is presumably relying on in claiming an equitable entitlement to a share in the reserve account.

40. The present case, it must be remembered, does not deal with an early withdrawal from the fund, but is a situation akin to a break-up of the fund. In these situations, by virtue of section 14, attention must be given to the equitable claims of members to surpluses or reserve accounts, and the possible distribution of those funds, especially in a defined contribution arrangement where the surplus has crystallised in a reserve and cannot be considered notional.
41. If one examines the nature of reserve account no 1 it becomes clear that it was set up for the exclusive benefit of the members. This is apparent from the following factors:

- the origin of the account (it was funded by a 25% enhancement on the actuarial values of the members who were transferred from the original IBM pension fund);
- the purposes specified in the rules for application of the funds in this reserve account;
- the historical record indicating that the fund has been used to augment members' benefits in the past; and
- the employer's exclusive access to its share of the surplus in reserve account no.2, deriving from the surplus in the previous fund, which it used to finance a contribution holiday.

42. From this it is apparent that the employer has no direct financial interest in reserve account no.1. The account is in existence primarily, if not exclusively, for the benefit of members. This is further borne out by the manner in which the transfer to employer reserve account no.2 was calculated. In terms of rule 13.1.9 the amount calculated by the actuary has to be "a proportionate share of the assets of the previous fund (the IBM pension fund) that are in excess of each individual's transfer value, and any amounts transferred in terms of Rule 13.1.8". Rule 13.1.8 regulates transfers to reserve account no.1 and thus by treating them as enhancements on the individual transfer values, the provision recognises them as amounts in respect of which the employer has no beneficial claim or interest.

43. *Prima facie*, therefore, members have a strong interest in the funds standing to the credit of reserve account no.1 in a break-up or transfer situation, approximating to beneficial ownership. This perception is strengthened when it is remembered that the original transfers into the IBM provident fund were without enhancement. This is somewhat at variance with what has become established practice in the industry in transfers of business where the transferor fund has substantial surplus assets. However, that is not to say that a transfer of

aggregated enhancements to a reserve account for use as an investment buffer is an illegitimate practice, the point rather is that the members' claims on that reserve are stronger than otherwise might be the case.

44. I turn now to an examination of the reasons put forward by the first respondent for the non-exercise of discretion by its trustees in awarding enhanced transfer benefits to those members who transferred to the Penlink provident fund.
45. Firstly, it avers, the discretion had to be exercised by IBM in terms of rule 4.4.3(c) who refused to do so because it viewed reserve account no 1 as an important aspect of the IBM provident fund's ability to maintain stability, and that in view of the many uncertainties facing pension and provident funds in general, reserve account no1 should be conservatively utilised. Secondly, it alleges that a payment to the members transferring out of the fund would discriminate against those remaining, to whom no distribution could be made, and against those who have already ceased to be members by retirement or early withdrawal, to whom no similar payment can be made. Finally, it asserts that actuarial predictions indicate that by the year 2010 reserve account no 1 will be depleted due to the impact of increased cost of death and disability benefits due to factors such as Aids.
46. The first and third arguments could equally be used in support of why the transferring members should be entitled to a proportion of the reserve to protect them from precisely the same dangers, and I am accordingly not persuaded by these reasons.
47. As regards the second contention, it seems to me that the ongoing members will continue to have the benefit of their pro-rata share of the reserve account for investment boosters and cost of death and disability subsidy. As for members who have already departed, it is a factor to be considered, but not one to which undue weight should be given when considering the broader equitable entitlements that arise in a transfer situation.

48. When all the relevant circumstances are considered it is clear to me that the first and second respondents have not complied with the statutory duty imposed on them in terms of s14 of the Act, in that they have not ensured that the transfer scheme affords full recognition to the rights and reasonable benefit expectations of the persons concerned.
49. This is not a case dealing with a surplus, where there are competing interests and stakeholders, or where it is appropriate for a distribution percentage to be arrived at by negotiation or exercise of discretion. On the contrary, reserve account no.1 is for the exclusive benefit of the members. A fixed percentage of those members are transferring to a new fund, and it is only equitable and reasonable that they be entitled to take a pro-rata portion of that reserve with them into the new fund.
50. The complainant is therefore entitled to an order directing the trustees of first respondent to transfer to the Penlink provident fund for the credit of the complainant an amount equal to that percentage of reserve account no.1 that reflects his fund credit expressed as a percentage of the total fund credits of the fund membership as a whole.
51. The preliminary ruling of this tribunal is as follows:
 - 52.1 IBM SA (Pty) Ltd is hereby joined as a party to this complaint in terms of section 30G(d).
 - 52.2 The first respondent is directed to furnish IBM SA (Pty) Ltd with a copy of the complaint, the first respondent's response and the complainant's reply together with all annexures, within 7 days of the date of receiving this ruling.
 - 52.3 A rule *nisi* is hereby issued calling upon the parties to show cause by 30th June 2001 why the following order should not be made:

The trustees of the IBM SA 1994 Provident Fund are hereby directed to transfer to the Penlink Portfolio Provident Fund to the credit of complainant's account an amount equal to that percentage of the Reserve Account no1 in the IBM SA 1994 Provident Fund that reflects the complainant's fund credit at the time of exiting the fund expressed as a percentage of the total fund credits of the fund membership as a whole as at the date of transfer, together with interest as provided for in section 2 of the Prescribed Rate of Interest Act, 55 of 1975 from the date of transfer to date of payment.

Dated and signed at CAPE TOWN on the 24th of MAY 2001

JOHN MURPHY

Pension Funds Adjudicator