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Pension Funds Adjudicator

Press Office Feature : PFA dismisses complaints against fund with r166-million deficit

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The deficit had grown due to an inappropriate investment strategy

The Pension Funds Adjudicator Muvhango Lukhaimane has dismissed claims of maladministration against a pension fund although it had a substantial deficit of more than R166-million.

Ms Lukhaimane was satisfied that the correct procedures had been put in place in terms of the Pension Funds Act to restore the financial stability of the pension fund.

Six employees of the Mafikeng City Council accused the Mafikeng City Council Pension Fund (first respondent) of maladministration, resulting in it being underfunded and unable to comply with its statutory obligations regarding payment of benefits.

The complainants said that before 1994, the first respondent was administered by Old Mutual (SA) Limited and was properly run and they even earned demutualisation shares.

They said that after 1994, the first respondent changed the administrator to the Liberty Group Ltd (second respondent) without informing them.

At one of the union meetings, they were informed that the first respondent was in deficit of about R94 million and they were assured that the third respondent would address the deficit.

The complainants submitted that this problem had since worsened. They were concerned that due to the fund not being in a sound financial position, they would not have sufficient funds for their retirement, death or disability.

They further submitted that due to the poor administration of the first respondent, there were no proper or guaranteed investments. They were also uncertain as to what happened to the demutualisation shares which had accrued to them and for which they had been allocated certificates.

The complainants said they were not aware of the response of the third respondent to the letter of December 2013 by the second respondent.
They feared that an adverse decision may be taken by the third respondent as its senior management was not part of the first respondent as it was employed on a

contract basis.

The complainants requested the OPFA to investigate and order an audit of the first respondent to determine how the deficit came about from 2000 to date. They wished to establish where their monthly contributions were invested and the reasons for the poor performances of the first respondent. The complainants needed information regarding their guaranteed payouts.

The first and third respondentsdid not provide the OPFA with any response to the complaints.

The second respondent admitted the first respondent had a substantial deficit and that if it was not addressed, it would struggle to pay its members their benefits when they become due. It submitted that currently, the first respondent was still able to pay benefits when they became due.

It also said the reasons for the deficit appeared in its letter dated 3 April 2014 addressed to the chairman of the first respondent.

The second respondent said it had also reported the first respondent to the Financial Services Board ("the FSB") which called on the first respondent to produce a plan in terms of Section 18 of the Act on how the board of the first respondent proposed to address the deficit.

It submitted that to date no response was provided by the first and third respondents regarding the deficit. On 18 April 2014, it was informed by the FSB that it had taken up the issue of the deficit with the first respondent.

The second respondent said the complainants did not indicate the basis of why they alleged that the first respondent was being incorrectly administered. It submitted that if the allegation stemmed from the deficit, it referred to its letter to the board and its recommendations therein.

The second respondent denied that it had poorly administered the first respondent. It submitted that the allegation that the first respondent was being poorly administered was incorrect as the first respondent was a defined benefit fund and its benefits were guaranteed by its rules rather than by the underlying investment portfolio. Further, the board of the first respondent determined its investment strategy.

The second respondent submitted that when Old Mutual demutualised at the beginning of 1999, it awarded shares to all its qualifying members who held policies at midnight on 25 September 1998. As part of this process, the first respondent was awarded some shares.

Its records showed that a total of 548 113 shares were awarded to the first respondent. The board at the time decided to allocate these shares to members of the first respondent whilst the dividends from these share would accrue to the first respondent.

As part of this decision, members who were allocated shares were provided with share certificates reflecting their share allocation.

These shares were under the board's control, which from time to time, authorised payment to the members in terms of the first respondent's rules. The second respondent submitted that it assisted with the payment at the request of the

board.

With regard to the complainants’ request for an audit, the second respondent said its annexure discussed the cause of the deficit. The FSB would most likely also look at these causes.

With regard to where current contributions were going, the second respondent said the paymentswere invested in terms of the current investment strategy which was approved by the board in July 2013.

With regard to the submission that the second respondent be investigated for enriching itself and failing to give the members their just dues, the second respondent said the board of the first respondent chose the portfolios in which the assets of the first respondent should be invested.

Before changes were made to the investment strategy in July 2013, of the six portfolios in which the assets of the first respondent were invested, only one was the second respondent’s portfolio and the remainder were invested in Old Mutual and Investec portfolios.

The second respondent submitted that in terms of the new strategy, the first respondent’s assets were invested in the Stanlib, Liberty, Coronation and Old Mutual portfolios. Like other asset managers, it only charged investment fees as agreed with the board. It denied any wrongdoing and committed to submit itself to any enquiry, if instituted.

It said that following the implementation of the new investment strategy in July 2013, there had been an improvement in the investment returns. It also submitted that it conducted its business and deals with its customers in a transparent manner.

It added that the first respondent was a defined benefit fund. As a result the benefits payable by the fund were defined in terms of its rules and were calculated in terms of a formula which took into account the years of service and the average salary of the member a few years before retirement.

If for some reason, the assets in the fund were insufficient to pay benefits, the employer would be required to add into the fund as much money as may be required to pay benefits that were due.

In her determination, Ms Lukhaimane said the first respondent had a substantial deficit. According to the letter from the second respondent to the first respondent dated 17 December 2013, the deficit as at 1 July 2013 stood at R166 612 455.

She said the cause of the deficit appeared to be in dispute. The complainants submitted that the deficit in the first respondent coincided with the second respondent’s takeover of the first respondent’ administration, indirectly implying the second respondent was the cause of the deficit in the first respondent.

The second respondent denies that it was responsible for the deficit. In its letter of 3 April 2014 to the chairman of the first respondent’s board, the second respondent submitted that:

- The deficit as at 1 July 2006 amounted to R14.6 million. This deficit amount, updated with the expected rate of return over the period from 1 July 2006 to 1 July 2013, amounted to a strain of approximately R27 million as at the valuation date.

- The fund's investment strategy was inappropriate as approximately half of the assets of the fund were invested in cash, which as an asset class, was a poor match for salary inflation. The other half of the assets was invested in a guaranteed portfolio, which was overly conservative given the nature of the liabilities of the fund.
- The inappropriate strategy resulted in the actual investment returns being lower than expected based on the assumptions used for purposes of the valuation, resulting in a strain to the fund of approximately R23 million.
- The actual salary increases that were granted to the employees were higher than assumed for valuation purposes resulting in a strain to the fund of approximately R81 million.
- The employer contributions towards funding the future benefits accrual and the risk premiums were lower than those required based on the actuarial valuation assumptions. This resulted in a strain to the fund of approximately R19 million.

Ms Lukhaimane said that in its submissions, not only did the second respondent deny that it was the cause of the deficit; it also submitted that the deficit was in existence when it took over the administration of the first respondent.

"It submitted that among others, the deficit had grown due to an inappropriate investment strategy of the first respondent's board, the salary increases of the members that were higher than expected actuarial assumptions and the employer contributions that were less than the actual contributions required.

"The second respondent submits that it has reported the issue of the deficit to the FSB as it is required to and it has indicated the necessary recommendations that would bring the first respondent to normality or alternatively to convert it from a defined benefit to a defined contribution fund.

"On the evidence submitted, this Tribunal is not convinced that the second respondent is the cause of the deficit as submitted by the complainants."

Ms Lukhaimane said despite the fact that the second respondent may not be the cause of the deficit, the existence of the deficit and the concerns of the complainants flowing therefrom still needed to be addressed.

Section 18 of the Act provides for instances where a pension scheme is not in a sound financial position and is unable to meet the financial needs of its members.

In such cases, the Registrar shall direct the fund to submit a scheme setting out the arrangements which have been made or which it is intended to make to bring the fund into a financially sound condition within a reasonable period.

This Tribunal takes note that the Registrar has requested the first and third respondents to submit a scheme in terms of Section 18 of the Act.

Ms Lukhaimane dismissed the complaint against the second respondent for maladministration of the first respondent.

She made no finding regarding the deficit in the first respondent as the matter was subject to a process in terms of Section 18 of the Act.

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