4th Floor
Riverwalk Office Park
Block A, 41 Matroosberg Road
Ashlea Gardens, Extension 6
PRETORIA
SOUTH AFRICA
0181

P.O. Box 580, **MENLYN,** 0063
Tel: 012 346 1738 / 748 4000
Fax: 086 693 7472
E-Mail: enquiries@pfa.org.za
Website: www.pfa.org.za

Please quote our reference: **PFA/GP/00109049/2024/AT**

REGISTERED POST

Dear Sir/Madam,

DETERMINATION IN TERMS OF SECTION 30M OF THE PENSION FUNDS ACT, 24 OF 1956 ("the Act"): TOTAL ENERGIES MARKETING SOUTH AFRICA ("complainant") v TOTAL OIL PRODUCTS PENSION FUND ("fund")

[1] INTRODUCTION

1.1 This complaint concerns the apportionment of a surplus benefit by the fund in terms of section 15C of the Act.

1.2 The complaint was received by the Adjudicator on 14 February 2024.

On 16 February 2024, the Adjudicator requested the complainant to provide further information. An acknowledgement of the complaint was sent to the complainant on 21 February 2024. On the same date, the complaint was sent to the fund requesting its response by 21 March 2024. A response dated 20 March 2024, was received from the fund on 21 March 2024. On 22 March 2024, the complainant was requested to reply to the fund's submissions by 3 April 2024. On 26 March 2024, the complainant requested an extension of 7 days, which was granted.

Further submissions were received from the complainant on 12 April 2024. On 15 April 2024, the fund was requested to reply to the complainant's further submissions by 26 April 2024. Further submissions were received from the fund on 24 April 2024. Further submissions were received from the complainant on 23 May 2024. On 8 July 2024, the Adjudicator requested an actuarial evaluation from Simeka Consultants and Actuaries (Pty) Ltd ("Simeka"). A response was received from Simeka on 14 August 2024. On 15 August 2024, the fund and employer were requested to reply to Simeka's submissions by 23 August 2024. Further submissions were received from the complainant on 22 August 2024. Further submissions were also received from the fund on 23 August 2024 and 30 August 2024.

1.3 Having considered the written submissions, it is considered unnecessary to hold a hearing in this matter. The determination and reasons therefor appear below.

[2] FACTUAL BACKGROUND

2.1 The complainant is a participating employer in the fund. An actuarial surplus in the amount of R551 872 000.00 was available for distribution, and the fund resolved to apportion 55% of the surplus to the member surplus account, to be used for the benefit of contributory members, pensioners, and former members, in terms of section 15D of the Act and 45% to the employer surplus account to be used for the benefit of the complainant in terms of section 15E of the Act.

2.2 The complainant disputes the surplus apportionment of 45% that was allocated to it by the fund.

[3] COMPLAINT

3.1 The complainant submitted that the issues in the complaint are the following:

- whether the fund improperly exercised its discretion in allocating 55% of the actuarial surplus to members and pensioners, and 45% to its surplus account.
- the complainant submitted that the appropriate and proper split of the actuarial surplus is 63% to its surplus account, and 37% to the member's surplus account.

3.2 The complainant submitted that the fund was established on 1 January 1956 as a defined benefit fund. The fund was closed to new entrants with effect from 1 December 1994, and as at 30 June 2022, it had an active membership of 16 and 329 pensioners. The complainant submitted that it is the sole employer participating in the fund.

3.3 The complainant submitted that on or about 31 December 2021, Alexander Forbes prepared a statutory actuarial valuation of the fund and determined that an actuarial surplus in the amount of R551 872 000.00 was available for distribution. The complainant submitted that on 21 November 2022, the fund notified stakeholders that it resolved to apportion 55% of the surplus to the member surplus account, to be used for the benefit of contributory members, pensioners, and former members, in terms of section 15D of the Act and 45% to the employer surplus account to be used for the benefit of the complainant in terms of section 15E of the Act and invited any representations to be made by stakeholders before finalising the distribution.

3.4 On 9 June 2023, the complainant informed the fund that the proposed split was unfair and that a more appropriate split would be 63% to it and 37% for the employee based on the following reasons:

- The fund's financing comprises contributions from both employees and employers, with 12% of pensionable remuneration from the complainant and 7% from members. This results in the complainant contributing 63% of the total contributions, calculated as 12/19ths of the entire contribution; and

- The complainant sponsored the investment strategy implemented by the fund over the past years and agreed to bear the risks associated with this strategy. Moreover, the complainant bears longevity, wage inflation, and expense risks.
- If a deficit occurred, the employer would have been asked for a new contribution to cover the shortfall. Although it is theoretically possible to raise member contribution rates or reduce benefits, the impracticality arises due to consent requirements for such actions. Furthermore, pensioners would retain their entitlement to full pensions.

3.5 The complainant submitted that on 21 July 2023, the fund provided a response to its letter dated 9 June 2023 and indicated that the rationale for its decision on a 55%/45% split was based on its determination that:

- the surplus originated from investment returns, particularly after 2008, due to a liability-driven investment strategy adopted by the trustees, and
- members (especially pensioners) were more exposed to the risks than the complainant.

3.6 The fund responded to the complainant's submission that the appropriate split should be 63%/37% by indicating that:

- 70.5% of the surplus came from assets backing pensioner liabilities, making the complainant's proposed split allegedly irrelevant to this portion;
- Pensioners would suffer lower, or no pension increases before the complainant's guarantee kicked in, justifying the split;
- Longevity and expense risks were mitigated, and investment risks were managed through strategic asset allocation. For example, the purchase of an annuity policy in May 2022 was funded by assets backing pensioner liabilities without needing to dip into the pensioner solvency reserve, which allegedly indicated that the risk to the complainant had been removed;

- the reduction of active members has reduced the potential impact of adverse wage increases.

3.7 The complainant submitted that the board asserted that its decision resulted in a fair allocation, benefiting the complainant more than if based solely on contribution rates. On 17 October 2023, the fund notified the complainant that after adjusting the pensioner solvency reserve, the actuarial surplus was restated to R527 556 000 as at 21 December 2021.

3.8 On 7 November 2023, the complainant responded to the fund indicating that:

- the assets belong to the fund as a whole, it is therefore incorrect to try and distinguish some of the assets as pensioner assets. The complainant acts as a guarantor of the fund assets if these assets prove to be insufficient to cover the benefits offered by the fund. The complainant therefore carried the risk.
- despite the possibility of pensioners experiencing smaller increases in the short term due to underperforming assets, the complainant remained liable if the assets fell below the levels necessary to secure increases according to the policy. Minimum increases also enable subsequent catch-up increases to compensate for periods of lower adjustments. The efforts of the trustees and the actuary to ensure the fund had ample assets, did not, and do not absolve the Complainant of its responsibility to provide the guarantee.
- the fund rules, coupled with the pension increase policy, established the expectation that members would receive a pension increasing by 80% of inflation. The outsourcing of pensions resulted in a significant enhancement of expectations for pensioners, funded by the surplus and reserves. The current distribution plan for the section 15C surplus does not consider this utilization of surplus, effectively pre-allocating it to pensioners. Pensioner rights have been fully satisfied, and there is no reasonable basis for pensioners to anticipate further benefits, given the generous terms under which annuities were procured. Therefore, the

proposal to allocate less than half of the remaining surplus to the employer is deemed particularly harsh, considering pensioners have already received full benefits according to the rules of the fund, while expressing a further desire to share in the majority of the surplus.

- the assertion that the expense reserve is deemed "adequate" for future expenses does not detract from the fact that, if the surplus is distributed, and members and pensioners receive their funds, the complainant would be left as the obligated party to the liquidator for closing the fund, settling any potential debts in the case of a shortfall. The costs associated with purchasing annuities, inclusive of future administrative expenses, are covered by the annuity price, partly funded from surplus and reserves. This result in a skewed arrangement where the party assuming the majority or all of the risk becomes the minority beneficiary in the distribution of any surplus in the fund.
- The fund proposed distribution is unfair as the complainant was both the majority contributor to the fund, as well as the main party exposed to the risk of having to step in if the assets turned out to be insufficient.
- the complainant maintained that it should receive 63% of the surplus in the fund being the relative member and employer contribution rates, which split has been found to be generally acceptable to the employer and members/pensioners in other pension surplus distributions.

3.9 On 10 November 2023, the fund replied to the complainant and denied that it failed to take account of the proportion of the contributions paid by it, and its status as guarantor. The fund further informed the complainant of its intention to proceed with the distribution.

3.10 The complainant submitted that the surplus apportionment date was 31 December 2003. Further, the rules of the fund do not specify the apportionment to be applied, and in terms of section 15C(2) of the Act, the fund can only determine the apportionment after taking into account the interests of all stakeholders. The complainant submitted that the

fund is required to take into account the interests of all stakeholders, and can only do so upon:

- considering all relevant factors pertaining to the matter under consideration;
- not allow itself to be influenced by factors that bear no relevance to the decision to be made; and
- not fetter its discretion by adhering blindly to a pre-determined position or policy without considering the individual circumstances of the case.

3.11 The complainant submitted that the following are the grounds for setting aside the fund's decision:

- There are no facts or other factors giving rise to expectations beyond what members and pensioners are legally entitled to as:
  - The fund is a defined benefit fund, and the benefits are defined by a formula contained in its rules.
  - The benefits in the fund are guaranteed by the complainant irrespective of the investment returns of the fund, or the level of member and employer contributions.
  - Section 14A(1) of the Act prescribes a minimum benefit to be paid to a member of a fund who ceases to be a member of the fund prior to retirement in circumstances other than liquidation, which minimum benefit shall not be less than the minimum individual reserve. And by requiring a pension increase to pensioners and deferred pensioners, at least once every three years, with effect from the valuation date on which the increase is based, which increase shall not be less than the minimum pension increase, starting with the first actuarial valuation following the commencement date.
  - As a result of the minimum benefits, the members and pensioners are guaranteed to receive a benefit that covers their expected benefits from the fund.
  - Currently, the members have already received their complete minimum benefits as outlined in the Act. As a result, they are fully compensated to support the establishment of a pension in accordance with the fund's benefits. These stakeholders

have thus received their full prescribed minimum benefits and more.

- Given that these minimum benefits are guaranteed by the complainant, any surplus or excess beyond the prescribed minimum benefits should be seen as excess contributions made by the complainant as the employer, which excess should be recognised and reflected in the split of the surplus.
- There is thus no reasonable basis for a member or pensioner to have any expectation to receive further benefits.

- The complainant guarantees the benefits in the fund and carries all of the risks.

    - If assets in the fund prove to be insufficient to cover the benefits of the fund, then and in such event, the complainant is required to provide additional funding if required.
    - The complainant thus carried the risk on behalf of members and pensioners, and this risk should be recognised in the determination of the split of the surplus.

- The fund contends that the majority of the surplus was earned on pensioner assets.

    - the assets situated within the fund is owned by the fund. It is therefore incorrect to suggest that assets can be classified as “pensioner assets”, or that this is a factor to be taken into account in determining the split.
    - instead, the origin of these assets derives from member and employer contributions. The complainant contributed 12% whereas members only contributed 7%. The complainant’s contribution translates to 63% of the share contribution.
    - therefore, based on the origin of the assets, the complainant made a greater contribution than members/pensioners and should be entitled to a greater share in the surplus of 63%.

- In light of the above, the complainant contends that the fund’s decision to allocate a split of 55%/45% of the surplus stands to be set aside on the following grounds:

    - There was no genuine opportunity for the complainant to make any representations prior to the fund taking a decision.

Instead, the fund took a decision on the split, thereafter, informed the complainant of the decision, and only then invited comment. In the absence of a genuine opportunity for the complainant to make representations for consideration by the fund prior to issuing its decision, the decision is procedurally unfair;

- In failing to consider the representations provided by the complainant, the fund failed to take account of relevant considerations;
- The findings and conclusions are not rationally connected to the information before the fund, and in particular, disregarded the interests of the complainant;
- The findings and conclusions reached by the fund are so unreasonable that no reasonable person could have reached the decision and conclusion; and
- the decision was not objectively rational nor proportional.

3.12 The complainant requests the Adjudicator to investigate the matter and seeks the following relief:

- The decision of the fund to apportion 55% of the surplus in the fund to the member surplus account, and 45% to the employer surplus account be and is hereby set aside.
- Directing the fund to split the actuarial surplus by apportioning 37% of the surplus in the fund to the member surplus account, and 63% of the surplus in the fund to the employer surplus account.
- Such further and/or alternative relief deemed by the Adjudicator to be just and equitable.

Further submissions

3.13 On 12 April 2024, the complainant submitted that in terms of section 15C of the Act, the surplus apportionment is determined in terms of the rules of the fund or by the board of the fund carrying out its fiduciary duty. The fund argues that it considered all relevant facts, applied the law, and formulated a fair decision.

3.14 The complainant submitted that the fund's position appears to be that, since its own investment strategy yielded the surplus, it was entitled to do as it pleases in the apportionment of the surplus. The result is that the fund exercised no discretion at all. To the contrary, the fund acted arbitrarily in apportioning the surplus. On the fund's own version, it asserts a right to do as it pleases, as opposed to exercising a fair and somewhat judicious approach in matters where a balancing of factors is required. Moreover, the reasons provided by the fund for the apportionment show that it acted unreasonably and, in fact, unfairly discriminated against it.

3.15 The complainant submitted that the fund elevated and placed greater importance on its own investment strategy. This was irrelevant in determining a fair and equitable distribution. Section 15C of the Act states that the board must take into account the interests of all the stakeholders in the fund. Further, the fund's investment strategy appears, from the response, to be the single most important factor taken into account by the board when determining the apportionment of the surplus. In doing so, the board considered irrelevant factors and came to an unreasonable determination.

3.16 The complainant submitted that while it is correct that its contribution did not increase, the same is true for the members' contribution. Both of these facts are relevant, yet the fund only took into account the fact that its contribution did not increase. The fund's failure to take into account and compare the non-increase in the members' contribution constitutes a failure by the fund to consider all relevant facts and the interests of all stakeholders.

3.17 Further, while the fund appears to have considered that the complainant had never actually been called upon to cover any shortfall, the fund failed, at the same time, to consider that the members had themselves never suffered any loss in the fund. The fund's failure to

take this into account constitutes a failure to consider all relevant facts and the interests of all stakeholders.

3.18 The complainant submitted that there is no justification for apportioning a greater portion of the actuarial surplus to the members. Further, the objective facts demonstrate that the apportionment ought, at the very least, to have been apportioned equally (50%/50%). Nothing in the fund's response justifies the 45%/55% split in favour of the members.

3.19 The complainant submitted that it did not demand that the entire surplus should be apportioned to it. Further, this is a matter where it would be appropriate for the Adjudicator to substitute the fund's decision.

3.20 On 23 May 2024, the complainant submitted that no new matter was raised in its reply and significantly the fund has not pointed out what such new matter entails. It indicated that it was the largest contributor to the fund and also carried the ultimate risk of having to step in if additional funds were required or necessitated. Further, the fund unfairly considered that the pensioners owned the pensioner assets whilst the complainant submits that a broader approach is more appropriate and fair. The assets are there to support both, namely, to support the payment of pensions as well as the employer who ultimately carries the risk of supporting the pensions in the future. The complainant submitted that in order to bring the matter to a conclusion, an equal distribution is justified, if not warranted.

[4] RESPONSE

Fund

4.1 The fund provided the background, surplus build-up, and events leading to the distribution of the surplus. However, the Adjudicator will not go into the details to avoid issuing a lengthy determination. The

fund submitted that it is clear that the complainant seeks the unlawful exercise of the board's discretion. It submitted that according to the complainant, the only relevant factor is the fact that it is the guarantor of last resort. Further, the complainant does not consider that members and pensioners ought to receive any surplus because according to it, they have already received their full benefit entitlement in terms of the rules of the fund. There are at least six problems with this:

- First, it goes against a purposive interpretation of surplus legislation which requires consideration of all stakeholders, especially in light of the pre-surplus legislation position where employers sought to retain most if not all of the surplus, especially in defined benefit funds where the employer is the guarantor of last resort as the complainant argues.
- Second, it goes against the point that surplus is by definition additional monies to be distributed to stakeholders in the board's exercise of discretion notwithstanding any benefit entitlement (and in addition thereto) in the rules of the fund. The complainant similarly has no entitlement to any surplus or benefits in terms of the rules of the fund merely by virtue of being the guarantor of last resort as is typical in defined benefit funds.
- Third, it contradicts the complainant's later position that members, former members, and pensioners ought to receive 37% of the available surplus.
- Fourth, it disregards – and would require the fund unlawfully to disregard – at least the following relevant factors in addition to the members' and pensioners' interests generally:

    - The extent to which the fund's investment strategy and conservative actuarial assumptions and reserve provisions (in respect of pensioner and member liability as well as expense and longevity risk mitigation) has mitigated the complainant's risk as underwriter of last resort.
    - The extent to which the fund's pensioners would forego (partially or fully) any pension increase before the complainant would have been called upon to contribute any additional funds.

- The fact that none of the risks which the complainant could have become liable for had eventuated. The complainant has not in fact spent any additional Rands in its role as “guarantor of last resort” and despite this, the fund proposes to apportion to the complainant the large amount of about R230 million, which the complainant says is unfairly little and prejudices it. (Exactly how receipt of R230 million prejudices the complainant which has not incurred any additional expenses for which it arguably ought to be compensated, the complainant does not say).

    - The extent to which the fund-driven investment strategy optimised contributions received and resulted in sufficient assets to meet the fund’s liabilities.

- Fifth, it reduces the surplus exercise to the absurd: if the only relevant factor is the proportion of contributions allocated between employer and employee (but both forming part of the employee’s remuneration) then there would be no point in giving the fund’s board a broad discretion. Every surplus exercise would fall along these artificial lines, giving employers an opportunity to direct that the bulk of the contributions be labelled “employer contributions” so as to ensure that the employer received most of any future surplus. This is against the plain language and purpose of section 15C.
- Sixth, the complainant’s core factual basis on which it alleges entitlement to 63% not 45% of surplus, is that the complainant has contributed the fixed percentage of 12% contributions, while the members “only” contributed 7%. This distinction is a fiction. Both the 12% and 7% form part of the affected employees’ remuneration, which is determined by agreement between the complainant and employees. The 12% “employer contribution” is not, properly characterized, a complainant expense. There is also no inherent reason why an employer contribution necessarily has to be more than the employee contribution – the 19% total monthly contribution rate could have been split up in any other manner or proportion. It was, for the reasons already stated, never a clear case that the complainant would be the guarantor of any shortfall. This is clear firstly from the fund rule that allows the reduction of benefits, secondly the rules do not place an obligation on the complainant to increase its contributions thus it always had the right to refuse and thirdly the rules provide that if there was a shortfall both member and employer contributions may be increased.

4.2 The fund submitted that the complainant's central argument that the fund's process was procedurally unfair has no merit. Further, that:

- Section 15C does not require the fund to seek and consider submissions from all or any stakeholders.
- The fund nonetheless sought submissions from stakeholders within a two-month period in respect of what was clearly a decision open to reconsideration by the fund upon receipt of relevant submissions. (This decision is also capable of being reconsidered as it is not administrative action, and the fund was not functus).
- The member and pensioner stakeholders provided submissions within this period. The fund considered these submissions, which did not relate to the overall 45/55 split.
- The complainant failed to provide submissions on time.
- The fund nonetheless granted to the complainant, or in some instances, the complainant just demanded and exercised such, at least four extensions to make its submissions over a period of several months. At no stage did the complainant allege that the fund's process was unfair, until this complaint. In a number of these extension letters, the fund emphasised that the purpose of the submissions was to enable the fund to assess if it needed to review its allocation decision.
- The complainant eventually made its substantive submissions in June 2023 – about seven months after the request for submissions was sent. The fund nonetheless considered these late submissions. In its submissions, the complainant made no reference to any new factor that the fund had not already known of and taken into account. It is obviously known to the fund what the contribution percentages are and that the complainant is the guarantor of last resort.
- the fund continued to engage with the complainant to explain why the fund did not consider any of the factors raised by the complainant to change its allocation decision. The fund did not have to do this either.
- Plainly, the fund had taken the complainant's factors into account, and considered that it did not affect the fund's 55%/45% allocation decision. This "weight allocation" of the various factors before the fund is in the fund's sole discretion. It is clear that the complainant is simply dissatisfied with its allocation of about R230 million.

- the fund took further steps and subsequently invited the complainant to engage with it in respect of the surplus. The complainant declined to do so.
- The complainant has had a genuine - and extremely generous - opportunity to make submissions and be heard, despite having no right to make submissions in section 15C proceedings. As a result, despite not having any procedural fairness or *audi* obligations, the fund nonetheless provided an extensive opportunity for the complainant to be heard and applied its mind to its submissions.

4.3 The fund submitted that it is trite as the Supreme Court Appeal ("SCA") concluded in *Sentinel Retirement Fund v Masoanganye* (1003/2017) [2018] ZASCA 126 that section 5(1)(b) of the Act provides that "all the assets, rights, liabilities and obligations" of a fund are deemed to belong to the fund. Thus, all the surplus in the fund belongs to the fund. It indicated that the point that an employer contributing to a defined benefit, like the complainant, has no automatic right to a portion of the surplus was stated in *Tek Corporation Provident Fund and Others v Lorentz* (490/97) [1999] ZASCA 54. The fund submitted that no matter whether the fund is defined benefit in nature or not, the surplus belongs to the fund and the complainant has no right to it. The right to distribute surplus, as set out above, belongs to the board and the board only.

4.4 The fund submitted that the surplus apportionment date of 31 December 2003 was the surplus distribution in terms of section 15B of the Act and not related to the current distribution in terms of section 15C which is the subject of this complaint. Further, the board did take into consideration all relevant facts and exercised its discretion properly.

4.5 The fund submitted that from the outset the complainant misconstrues the provisions of section 15C in its entirety. On its version, it means that no party may share in the surplus if their minimum benefits have been provided for and that only the employer must receive the balance.

It indicated that this would clearly amount to a fettering of the board's discretion. The complainant's statement bears no legal foundation.

4.6 The fund referred to the definition of actuarial surplus in the Act and submitted that according to this definition, a fund's actuarial surplus is the difference between the value of the fund's assets on the one hand, and its liabilities on the other. It is, therefore, excess assets, and the argument that benefits have been paid or funded for is thus of no consequence in determining what is and what is not surplus.

4.7 The fund submitted that it is now common cause that the investment strategy which it followed resulted in no additional contributions to be made by the employer and therefore, the risk which the employer may have had to fund any underfunding of the fund and has as a fact not materialised. Further, as the surplus arose due to prudent investment strategy maintained by the fund it thus factually and legally incorrect to conclude that any surplus or excess beyond the prescribed minimum benefits should be seen as excess contributions made by the complainant as the employer, especially when in terms of the rules of the fund and the Act, the complainant as the employer has equally no right or entitlement thereto.

4.8 The fund submitted that the complainant does not guarantee the fund benefits as the benefits may have to be reduced should the fund liabilities not be fully funded. Further, it is in any event a fact that the complainant did not have its contributions increased and it is a fact that the investment return and investment strategy which the fund followed resulted in the surplus being built up and not due to any additional contribution or increased contribution by the complainant.

4.9 The fund submitted that it is correct, as stated above, that all assets belong to the fund and so does the surplus. It is also for this reason that the proviso to section 15C expressly provides that:

> "Notwithstanding anything to the contrary in the rules, neither the employer nor the members may veto such apportionment."

4.10 The fund submitted that the complainant had numerous opportunities to provide and to make representations far in excess of what the other stakeholders were provided. The reasons provided by the complainant for not providing submissions went from obtaining or awaiting a legal opinion as early as February 2023 to obtaining advice from industry experts to obtaining actuarial advice to obtaining legal and actuarial advice to its submissions on 21 June 2023. However, the fund properly considered and responded in detail to the submissions whereafter the complainant made no further submissions nor accepted the invitation to meet with the fund.

4.11 The fund submitted that there is no basis on which to conclude that the fund exercised its discretion unlawfully. Certainly, it is fair to allocate to the complainant the very large amount of R230 million in surplus – especially considering that the complainant never actually incurred any expense in respect of the underwriting risk that it took. As a result, the complaint must be dismissed.

4.12 In the alternative, the fund requests the following:

- If the Adjudicator decides that the board has not lawfully exercised its discretion (which is denied for all the reasons set out herein), then it can only refer the matter back to the board to re-exercise its discretion.
- The Adjudicator cannot substitute the board's allocation with the 63%/37% split preferred by the complainant, or with a different split that the Adjudicator may prefer. This would be unlawful and subject to further legal challenge.

Further submissions

4.13 On 24 April 2024, the fund submitted that the complainant's version is denied as if specifically traversed and the complainant is put to the

proof thereof. Further, the complainant now says that the fund's investment strategy should have been irrelevant in determining its surplus apportionment. It either mistakenly or willfully ignores the facts and/or misunderstands how section 15C applies. It also avers that the fund's position is that the fund is entitled to do as it pleases in respect of surplus apportionment. It submitted that this is incorrect. The complainant appears intent on misunderstanding the fund's case and plainly does not understand how actuarial estimates work in a defined benefit context. The fund submitted that:

- The surplus predominantly arose from pensioners' receipt of pensions from the fund and the fund's chosen investment strategy in respect of these pensioners. In this fund, the actuarial surplus has arisen, not from the experience of members prior to their retirement, since they made up only a small portion of the fund's liabilities and analysis of the sources of the surplus reveal little or no contribution from this source, but from the experience of the pensioners receiving pensions from the fund and the investment of the corresponding assets backing the pensioner liabilities which make up the bulk of the fund's liabilities.
- This is demonstrated by the actuary's determination that the fund's "Notional Pension Accumulation Amount" exceeded the sum of the present value of the fund's obligations towards pensions in course of payment and the pensioner solvency reserve by more than the total actuarial surplus available for distribution.
- This implies that the financial position of members still in service has been financed in part by the experience of pensioners and the assets backing pensions in course of payment. Or, to put it differently, there isn't any surplus arising from the experience of members prior to their retirement that would even potentially arguably be reasonable to split on the basis of the historic split of contributions (and which is denied).
- Throughout the period when the actuarial surplus arose after the surplus apportionment date (31 December 2003), the liabilities of the fund (and therefore the corresponding assets) were split as follows: 29.5% in respect of members prior to

their retirement and 70,5% in respect of pensioners being paid pensions by the fund. By 2024, there are only 7 members still in service. The balance of the membership are all pensioners.

- The board examined the risks to which the pensions in payment were exposed and how these risks would be experienced by pensioners and the complainant. The board did consider if, or when, the complainant could be required to make additional contributions, taking account of the provisions in Rule 14(d) that enabled an increase in either, or both, the complainant and the member contribution rates or a decrease in benefits. Having concluded that the pensioners would bear the full brunt of the first 30.4%1 of any fall in value of the assets before the complainant would be asked to make any additional contribution, and having considered the sources of the surplus, the Trustees decided that the members and pensioners should receive more than the complainant in the distribution of the surplus. The complainant provided no answer to this obviously relevant criterion.
- It is thus not only the complainant who is “at risk” – the pensioners also took a great upfront proportion of the risk as outlined below and not disputed by the complainant.
- After debate, the board decided on an award of 55% to members (including the pensioners) and former members and 45% to the Complainant as the Trustees felt that the members (including the pensioners) were more exposed than the complainant.

4.14 The fund’s investment strategy is ultimately for the benefit of pensioners and is not the fund’s “own interest” as the complainant attempts incorrectly to recharacterise it. It is a relevant and in fact standard consideration in surplus distributions to consider the reasons for the surplus build-up, including when it arose as a result of investment strategy. This is so from a legal perspective, as well as from an actuarial perspective as the fund’s actuary confirmed.

4.15 The fund submitted that it did not say that it did not consider that the members’ or pensioners’ risk did not eventuate. The fund did consider

this but considered pensioners, in particular, to be more (immediately) exposed risk-wise due to the pensioners being first on risk for an up to 30% fall in assets. It indicated that the complainant seeks the Adjudicator's endorsement that the fund ignored this consideration.

4.16 The fund submitted that a surplus ought not to be split simply on the say-so of the complainant. Further, the complainant does not say why it ought to be split 50%/50% and not 48%/52% for example, or in any other proportion. It simply invented this split. The fund submitted that a 50%/50% split is very close to the fund's decision of a 55%/45% split in favour of members. There is no basis on which to interfere with the weight attached by the fund to various factors to have arrived at a 55%/45% split.

4.17 The fund indicated that it is of concern that the complainant's departure point is that it has some kind of "right" to a minimum portion of the surplus (it appears, at least 50%) when this is not what section 15C provides. The complainant has no right even to the 45%, at least not before the surplus allocation decision has been made and then only as a result of this decision having been made. The complainant is simply dissatisfied with its allocation of "only" about R230 million.

4.18 The fund submitted that the Adjudicator has correctly been reluctant to substitute a board's exercise of discretion for the Adjudicator's preferred distribution decision, whether in surplus or death benefit or other similar cases: the fund emphasised that should the complaint be upheld, it is not for the Adjudicator to replace the fund's decision with its preferred, or the complainant's preferred, decision. As the complainant effectively admits, there are many potential alternative distributions, including a 50%/50% split. There is no foregone conclusion of any alternative split. The fund persists that the complaint must be dismissed, and in a best-case scenario, the complainant ought to be remitted to the fund. It simply cannot be substituted by the Adjudicator.

Simeka

4.19 Simeka provided an independent actuarial assessment of whether the board's apportionment of the surplus adheres to good practice and verified the correctness of the surplus sources. Simeka indicated that it has no concerns regarding the accuracy of the source of the surplus as shown in the statutory actuarial valuations of the fund.

4.20 Simeka submitted that by leaving the fixed member and the employer contributions in the fund unchanged, it was always going to be the case that the fund would eventually either be under or overfunded (with a negligible probability that the fund would just be 100% funded). It indicated that for this reason, the employer contributions to a defined benefit scheme are usually made flexible. The fixed contributions plus better-than-expected investment returns eventually led to the current surplus in the fund.

4.21 It submitted that the board placed excessive emphasis on the investment returns generated by the assets backing the pensioner liabilities, even though the assets were not segregated by membership category. It placed little to no value on the employer and member contributions, which (together with investment returns) created the assets backing the pensioner liabilities, as well as all the other assets of the fund.

4.22 Simeka submitted that while the board’s focus on investment returns is understandable, it presents an overly segmented view of the fund's assets, which have historically not been segregated. The assets backing the liabilities in respect of the pensioners should not be viewed in isolation from the members’ and employer's contributions that benefited the entire fund’s performance. Simeka indicated that it seems the board also focused on the risks faced by the pensioners, whilst

almost discounting the risks faced by the complainant as those risks did not materialise.

4.23 Simeka submitted that it does not agree with the reasoning followed by the board in exercising its discretion. Further, it supports the complainant's view that the proposed split of the surplus is unfair towards it. It indicated that the complainant's proposal that 12/19ths of the surplus should be allocated to its surplus account is very reasonable.

Fund's reply to Simeka's submissions

4.24 The fund indicated that the board agrees that the assets corresponding to the pensioner liabilities had not been segregated from the balance of the assets. The fund submitted that the board disagrees that it placed excessive emphasis on the investment returns generated by the assets backing the pensioner liabilities.

4.25 It submitted that it is expected that the capital needed on retirement will be fully financed by the time members retire. If annuity policies had been purchased on each pensioner's date of retirement, no surplus would have been earned on the assets backing pensions in course of payment. It indicated that the board does not agree that the split of contributions by active members and the complainant should in this instance have been taken into account when determining the split of surplus earned on assets backing pensions in course of payment.

4.26 The fund submitted that it agrees that pensioners had no legal right to surplus because of the history of full inflation increases. However, the pensioners have a reasonable expectation of participating in the surplus. The purchase of an annuity policy subsequent to 31 December 2021 is irrelevant to the pensioners' expectations of participating in a surplus distribution at that date. Such annuity policy purchase relieved the complainant of all and any of the risks associated with the

pensioners. The fund submitted that this is something Simeka does not mention.

4.27 The fund agrees that the board had a fiduciary duty to look after the best interests of all the stakeholders in the fund. It indicated that if only the contribution rates were to be considered, as is being suggested, the board would have failed to adhere to its fiduciary duties.

4.28 The fund submitted that the board agrees that member and employer contributions had financed the capital required on the retirement of members. But indicated that this does not give the complainant the right to enjoy a surplus earned on such capital after retirement. The fund submitted that the board disagrees that it placed little to no value on the employer and member contributions. The fund indicated that 45% is not little to no value. Further, there exist more reasons to have reduced the complainant's allocation than increasing it further.

4.29 The fund submitted that Simeka did not question the board's assertion that pension increases could be reduced by as much as 30% if adverse investment conditions were experienced before the complainant and/or employees are asked to pay in any amount in order to secure the 80% of inflation guarantee in the rules. It indicated that in the board's opinion, this is sufficient to tilt the distribution of surplus in favour of the pensioners.

4.30 On 30 August 2024, the fund submitted that the investment strategy was designed by the board in consultation with its investment consultants to minimise any possibility of either the members or the complainant being required to make contributions in addition to the 7% and 12% of pensionable remuneration as defined. No commitment was made by the complainant nor was any sought, to bear any risk associated with this strategy.

4.31 The fund submitted that before Rule Amendment 17, the old rules 44 and 45 gave the complainant no right to participate in surplus on termination of the fund. Any surplus remaining in the employer surplus account before liquidation would have had to be transferred to another fund in terms of section 15E. The fund indicated that this strengthens the argument that the complainant did not expect to participate in the surplus. The fund submitted that Rule Amendment 17, which was drafted by its consultant at the request of the board, requires the distribution of surplus amongst stakeholders, including the complainant, and the payment of any balance in the employer surplus account to the employer on liquidation.

4.32 The fund submitted that it is excess investment returns earned, after retirement, on the assets backing pension payments that have been greater than expected. Thus, Simeka's sense of fairness as espoused herein is irrelevant to the correct legal test.

Employer's reply to Simeka's submissions

4.33 On 22 August 2024, the complainant submitted that it agrees with Simeka's findings and, in particular, pointed out that Simeka opined that the proposed split as formulated by the fund is unfair towards it and its proposal that 12/19ths of the surplus should be allocated to the employer surplus account is very reasonable.

4.34 The complainant submitted that it persists with the relief it sought.

[5] DETERMINATION AND REASONS THEREFOR

Introduction

5.1 The issue to be determined is whether or not the fund improperly exercised its discretion in the allocation of the actuarial surplus in terms of section 15C of the Act and its rules.

Apportionment of a surplus in terms of section 15C of the Act

5.2 In the Supreme Court of Appeal (SCA) matter of *Municipal Employees Pension Fund v Mongwaketse* (969/2019) [2020] ZASCA 181 (23 December 2020) at paragraphs [42] to [44], Wallis JA held that the rules of a fund are its constitution, and that the doctrine of ultra vires applies. If the rules of a fund do not afford a fund the legal power or capacity to do something, then such purported act by the fund is ultra vires and accordingly null and void. The Constitutional Court affirmed the SCA's findings in *Municipal Employees Pension Fund and Another v Mongwaketse* (CCT34/21) [2022] ZACC 9 at paragraph [39] where it stated that the application of the ultra vires doctrine to pension funds is consistent with the constitutional principle of legality.

5.3 Section 15C of the Act provides as follows:

> **15C Apportionment of future surplus**
>
> (1) The rules may determine any apportionment of actuarial surplus arising in the fund after the surplus apportionment date between the member surplus account, the employer surplus account or directly for the benefit of members and former members subject to the uses specified in section 15D(1).
>
> (2) If the rules are silent on the apportionment of actuarial surplus arising after the surplus apportionment date, any apportionment between the member surplus account, the employer surplus account or directly for the benefit of members and former members, subject to the uses specified in section 15D(1), shall be determined by the board taking into account the interests of all the stakeholders in the fund: Provided that, notwithstanding

anything to the contrary in the rules, neither the employer nor the members may veto such apportionment.

5.4 Further, rule 14(c) of the fund provides as follows:

14 ACTUARIAL INVESTIGATIONS

(c) "If an actuarial valuation on or after 31 December 2014 reveals an actuarial surplus after all contingency reserve accounts deemed prudent by the Committee are fully funded in terms of the Actuary's recommendations, in terms of section 15C of the Act, the Committee may apportion this actuarial surplus to either, or some combination of, the member surplus account or the employer surplus account established in terms of this rule. Thereafter, the Committee may apply such actuarial surplus as allocated to these accounts in the manner, and for the purposes, set out in sections 15D and 15E of the Act, respectively. The member surplus account and employer surplus account shall operate in the following manner:

(i) the member surplus account shall be credited with such amounts of actuarial surplus as are allocated to it in terms of this rule, together with fund return thereon, and shall be debited with the cost of any of the uses of actuarial surplus implemented by the Committee in the manner and for the purposes set out in the Act; and

(ii) the employer surplus account shall be credited with such amounts of actuarial surplus as are allocated to it in terms of this rule, together with fund return thereon, and shall be debited with the cost of any of the uses of actuarial surplus implemented by the Committee in the manner and for the purposes set out in the Act, including the usage provided for in Section 15E (1) (c) as contemplated in Rule 15 (2)."

5.5 Thus, in terms of section 15C above, any apportionment of surplus between the member surplus account and employer surplus account is determined by the board by taking into account the interests of all the stakeholders in the fund. The stakeholder will include, *inter alia*, current and former members, pensioners and the complainant. It should be

stressed that any surplus that arises in the fund belongs to the fund and no stakeholder can claim entitlement to it or any specific percentage thereof. In terms of rule 14(c) above, the fund has discretion on how to allocate any surplus. However, the fund does not have an untrammelled power in the exercise of its discretion as it must be exercised reasonably by taking into account relevant factors and the interests of the stakeholders.

5.6 The current matter turns on whether or not the fund exercised its discretion reasonably in the allocation of the surplus. In its claim for a 63% allocation of the surplus to the employer surplus account, the complainant relies, *inter alia*, on the fact that it contributed 63% to the total contributions to the fund and agreed to bear the risks associated with the investment strategy and expenses risks. Further, it averred that if a deficit occurred, it would have been required to cover the shortfall, as this is a defined benefit fund. However, it is common cause that none of the risks that the complainant was exposed to materialised. Put simply, the complainant was not required to pay any additional contributions to the fund and fund any expenses associated with the investment strategy. It follows that the complainant cannot claim entitlement to a larger surplus (63%) solely based on the reasons advanced.

5.7 On the other hand, the submissions indicate that the fund allocated a surplus of 55% to the member surplus account based, *inter alia*, on the grounds that pensioners would suffer lower or no pension increases before the complainant would have been called upon to contribute any additional funds. Thus, the board examined the risks to which pensions in payment were exposed and how these risks would be experienced by pensioners. It based its conclusion on the grounds that pensioners were more exposed risk-wise due to being first on risk for an up to 30% fall in assets. However, the fund acknowledged that it considered the fact that this risk did not eventuate. The fund correctly asserted that it

would be incorrect to only consider the contributions to the fund in allocating the surplus.

5.8 The fund ultimately must exercise a discretion in order to achieve a fair and equitable allocation of the surplus. The complainant submitted that the rules of the fund do not specify the apportionment to be applied, and in terms of section 15C(2) of the Act, the fund can only determine the apportionment after taking into account the interests of all stakeholders. The complainant submitted that the fund is required to take into account the interests of all stakeholders, and can only do so upon considering all relevant factors pertaining to the matter under consideration; not allow itself to be influenced by factors that bear no relevance to the decision to be made; and not fetter its discretion by adhering blindly to a pre-determined position or policy without considering the individual circumstances of the case.

5.9 The fund submitted that section 15C does not require the fund to seek and consider submissions from all or any stakeholders. However, it still sought submissions from stakeholders within a two-month period in respect of what was clearly a decision open to reconsideration by the fund upon receipt of relevant submissions. The complainant failed to make submissions on time. The fund submitted that the board did take into consideration all relevant facts and did exercise its discretion properly. Further, the complainant has no right even to the 45%, at least not before the surplus allocation decision has been made and then only as a result of this decision having been made. The complainant is simply dissatisfied with its allocation of “only” about R230 million.

5.10 The matter was referred to Simeka for independent actuarial assessment of whether the board's apportionment adheres to good practice and verified the correctness of the surplus sources. Simeka’s findings found that the fixed member and employer contributions in the fund plus significant investment returns eventually led to the build-up of

the current surplus. It indicated that while the board's focus on investment returns is understandable, it presented an overly segmented view of the fund's assets in favour of the members, which have historically not been segregated. It stated that the assets backing the liabilities with respect to the pensioners should not be viewed in isolation from the members' and employer's contributions that benefited the entire fund's performance. Simeka established that the board focused on the risks faced by the pensioners and discounted the risks faced by the complainant, and by doing so, it failed to exercise its discretion fairly towards the complainant.

5.11 Although the fund indicated that it did consider the complainant's contributions to the build-up of the surplus by allocating 45% of the surplus to the complainant, the Adjudicator is not satisfied that the board properly considered the interests of the stakeholders concerned and the fact that both the members/pensioners and the complainant bore risks which did not materialise.

5.12 The board is vested with discretionary powers to decide on the apportionment of an actuarial surplus. It is only in cases where the board has exercised its powers unreasonably and improperly or unduly fettered the exercise of its discretion that its decision can be reviewed (see *Mongale v Metropolitan Retirement Annuity Fund* [2010] 2 BPLR 192 (PFA). The Adjudicator can only interfere with the board's decision if it is proved that the board has considered irrelevant factors and ignored relevant factors.

5.13 *In casu*, the Adjudicator is not satisfied that the board of the fund took into account all relevant factors and ignored irrelevant ones in the allocation of the surplus. The duty of the Adjudicator is not to decide what is the fairest or most generous allocation, but rather to determine whether the board has acted rationally and arrived at a proper and lawful decision. It follows that the board's decision in this regard falls to be set aside for the reasons set out above. The board must engage the

complainant further and re-exercise its discretion having regard to all relevant factors.

[6] ORDER

6.1 In the result, the order of the Adjudicator is as follows:

6.1.1 The decision of the board regarding the allocation of the surplus is hereby set aside;

6.1.2 The fund is ordered to engage the complainant further and re-exercise its discretion regarding the allocation of the surplus to the member surplus account and the employer surplus account, within eight weeks of this determination; and

6.1.3 The fund is ordered to inform the complainant and the Adjudicator of its decision, within two weeks of re-exercising its discretion in terms of the allocation of the surplus.

DATED AT PRETORIA ON THIS 10TH DAY OF OCTOBER 2024

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MA LUKHAIMANE
PENSION FUNDS ADJUDICATOR

Section 30M Filing: High Court

The parties: Unrepresented