IN THE TRIBUNAL OF THE PENSION FUNDS ADJUDICATOR
HELD IN JOHANNESBURG

CASE NO: PFA/FS/5271/05/CN

In the complaint between:

Hilton C Browne	**Complainant**
and	
South African Retirement Annuity Fund	**First Respondent**
Old Mutual Life Assurance Co. (SA) Ltd	**Second Respondent**
South African Revenue Service	**Third Respondent**
Competition Commission	**Fourth Respondent**

DETERMINATION IN TERMS OF SECTION 30M OF THE PENSION FUNDS ACT, 24 OF 1956 ("the Act")

INTRODUCTION

[1] This complaint raises the vexed question of whether a member of a retirement annuity fund may transfer his total interest in one approved retirement annuity fund to another *prior to retirement* in instances where the rules of the fund from which he wishes to transfer make provision for such transfer only upon his entitlement to the payment of an annuity. The complainant (currently 51 years of age and some 14 years away from retirement) wants to sever ties with both the South African Retirement Annuity Fund ("SARAF") and Old Mutual (SARAF's underwriter and administrator) because of what he says are "poor returns" on his retirement investment all these 20 years. He is also complaining about unexplained charges levied when he reduced his contributions and again when he stopped making contributions.

[2] The complaint was received by this office on 21 August 2005 and a letter acknowledging receipt thereof sent to the complainant on 23 September 2005. On the same date a letter was dispatched to SARAF and Old Mutual giving them until 20 October 2005 to file a response to the complaint. The response dated 20 October 2005 was received on 20 October 2005. SARAF and Old

Mutual appear to have sent a copy of the response to the complainant on the same date. A reply was received from the complainant on 1 November 2005.

[3] Following the signing of a statement of intent in December 2005 between the Minister of Finance, on the one hand, and the Life Offices Association and its constituent members, on the other, this tribunal has issued over a thousand letters in all retirement annuity fund cases to all parties thereto (and we continue to do so), affording the parties an opportunity to find an amicable settlement of cases *inter se* without the intervention of this tribunal, and within the purport and spirit engendered by the statement of intent. This was one such case. Many such cases have been settled between the parties. In this case, however, the complainant and first and second respondents could not reach an agreement because Old Mutual took the view that the underlying policy "*does not qualify for an enhancement in terms of the Statement of Intent*". This view appears to be premised on the submission that the charges effected when the complainant *reduced* his monthly contributions to SARAF (which in turn paid them as premiums in respect of the policy taken out by it with Old Mutual) and those charges effected <u>again</u> when he *stopped* contributions altogether, were "*within the parameters set out in the Statement of Intent*".

[4] Old Mutual's view brings the purport of the statement of intent into sharp focus in this case and I shall deal with that purport below.

THE FACTS IN BRIEF

[5] The complainant, a 51 year old man, appears to have been a member of SARAF since December 1986. He was then 31 years of age and he is still a member of SARAF. SARAF is underwritten and administered by Old Mutual. As is in the nature of underwritten retirement annuity funds, SARAF took out a policy with a life assurer (in this case Old Mutual) on the life of the complainant using the monthly contributions made by him to it. The commencement date of the policy (policy number 5122291) is recorded in the policy document as being 1 December 1986.

[6] It appears from correspondence that at the beginning of November 1995, and following his reduction of monthly contributions from R103.49 to R70, the complainant's accumulation account (defined in the policy document as comprising an accumulation of contributions plus declared bonuses less

expense charges and costs of risk cover, if any) was reduced by R454.43. On April Fools' Day of 1996, the accumulation account was again reduced by R816.05 following the policy being made "paid-up". This came about by reason of the complainant stopping contributions altogether.

[7] The effect of a policy being made "paid-up" is that "reduced benefits" then become payable upon the life assured's chosen retirement date or death, whichever event should first occur. The calculation of these "reduced benefits" is entirely in the discretion of the underwriter.

[8] On 19 July 2005, the complainant appears to have enquired of Old Mutual whether he could transfer his assets in SARAF to another approved retirement annuity fund. This becomes clearer from the complainant's correspondence dated 22 August 2005 wherein he makes it clear that he does not seek access to his retirement annuity fund capital but "[s]*imply to move it to* [another approved retirement annuity fund]". Old Mutual had responded to his enquiry in a letter dated 26 July 2005 saying "[g]*overnment legislation*" does not permit payment of retirement annuity benefits until age 55 or such other age above 55 as may have been chosen by the member, whichever event should occur *last*. It went on

to say the complainant's interest in SARAF may be transferred to another approved retirement annuity fund upon occurrence of the last-mentioned event.

COMPLAINT

[9] On 21 August 2005, the complainant then lodged a complaint in which he laments the "*very poor returns*" from SARAF and, as a result, seeks that his total interest in SARAF be transferred forthwith to another retirement annuity fund, which he mentions by name, and from which he considers he will receive considerably better returns. He submits that a return of 12.57% (quoted by Old Mutual to him as at 26 July 2005) over a 20 year period is a "*very poor return*".

[10] In correspondence dated 1 November 2005, the complainant questions the charges levied on him in "Nov 1995 & May 1996", presumably in relation to the reduction and subsequent cessation of contributions.

RESPONSE

[11] SARAF submits that its rules allow for the cessation of membership only in specified instances, none of which are applicable in the complainant’s case. It says those instances are: the death of a member; the winding up of the fund; the cessation of contributions by the member where as a result of such cessation no benefits are payable in terms of the policy; the payment of the benefit in full commutation of the annuity; transfer of a vested retirement benefit to another insurer; transfer, subject to certain conditions in the rules, of a member who is within two months of the vesting date of his or her retirement benefit; and transfer of a member to another approved retirement annuity fund of his choice where the policy is no longer available for purposes of the fund.

[12] SARAF submits further that the relevant provisions of the Income Tax Act, 58 of 1962, allow for the transfer of any member’s total interest in any approved retirement annuity fund to another approved retirement annuity fund only if such transfer is provided for in the rules of the former. Thus, so the argument goes, because the rules of SARAF do not provide for such transfer other than in the specified instances (and the complainant meets none of these instances),

SARAF cannot accede to the complainant's request.

DETERMINATION AND REASONS THEREFOR

[13] This complaint calls for the determination of two issues. The first is whether the charges levied on the accumulation account (as defined in the policy document) following the complainant's reduction of monthly contributions and, again, following cessation of contributions, were lawfully and properly levied. The second issue is whether, upon consideration of applicable legislation, the rules and the policy document, transfer by the complainant of his total interest in SARAF (an approved retirement annuity fund) to another approved retirement annuity fund *prior to retirement* is, in the circumstances of this case and for the reasons advanced by SARAF, impermissible.

[14] But before grappling with those two issues, I consider it opportune at this stage to deal with the true purport (as I understand it) of the statement of intent signed in December 2005 between the Minister of Finance, on the one hand, and the Life Offices Association and its constituent members, on the other. I do

so because, as in this matter, many retirement annuity fund complaints have found their way back to this tribunal for adjudication after we had referred them back to the parties for settlement in accordance with the purport and spirit of the statement of intent, the constant refrain of underwriters being that the level of costs of the kind here in question are "*within the parameters of the statement of intent*", or that "*the policy does not qualify for an enhancement in terms of the statement of intent*". It is my view that such an approach is not consonant with the statement both in letter and in spirit. A brief background of the statement of intent is necessary for that purpose.

Background and Purport of the Statement of Intent

[15] Following a flood of complaints against underwritten retirement annuity funds and a spate of rulings in such matters from this tribunal during 2005, many of which rulings were forwarded both to the National Treasury and the Financial Services Board for their information and possible action, this tribunal made written submissions to National Treasury on some of the problems we had identified in the practice of underwriters in relation to product development and

administration of underwritten retirement annuity funds.

[16] We identified at least ten issues. The first was the levying of charges – which we found undisclosed in the rules and policy documents – by reason only of a member *ceasing to make contributions* to the fund and, consequentially, the fund ceasing to pay premiums in respect of the underlying policy it had taken out with a life assurer on the life of the member. The second was the levying of similar charges by reason only of a member *reducing contributions* in circumstances where no provision for such charges is made in the rules or policy document. Thirdly, the levying of a charge upon a member *advancing his or her retirement age* even though the member is beyond the minimum retirement age of 55 years prescribed by the Income Tax Act; fourthly, the creation of *interest bearing loan accounts* for members without their knowledge for purposes of debiting their accumulation accounts with interest and ultimately with the capital sum of the loan in the event of the member either stopping contributions or reducing such contributions; fifthly, the *automatic charging of commission*, without members' knowledge, every time a member increases contributions, on the ground that every increase gives rise to a "new" policy; sixthly, the treatment of a *single lump sum contribution* as a series of recurring monthly contributions

in crass disregard for the member's wishes, thus progressively reducing the capital of the lump sum contribution until no more contributions can be levied therefrom so that charges for "premature cessation" of contributions are levied; seventh, '*minimum pension increase policy'* provisions in the Pension Funds Act which life assurers insist do not apply to retirement annuity funds notwithstanding there being no such exemption in any legislation to which they have referred; eighth, the *conflict of interest* to which the incestuous relationship between the trustees of underwritten retirement annuity funds, on the one hand, and the underwriter that employs them to administer the fund, on the other, gives rise; ninth, the undesirability of so-called *benefit illustration agreements* which seem aimed more at selling as many policies as possible than to place members in a position to make informed decisions when deciding to join a retirement annuity fund; tenth, the prohibition generally placed by underwriters against *transfer* of interests in one approved retirement annuity fund to another before the member concerned reaches his or her chosen retirement age.

[17] These issues were then taken up by National Treasury and used to engage with life assurers that underwrite retirement annuity funds. Therefrom sprang the statement of intent.

[18] The preamble (termed the "recordal" in the statement) is instructive of what the purport of the statement of intent truly is. It contains the following words, among others:

> "Whereas the members of the long-term insurance industry, as represented by the Life Offices' Association of South Africa (LOA), recognise the problems highlighted by the Pension Funds Adjudicator (PFA) with respect to the lack of transparency of costs and charge structures, with the result that the expectations of consumers in respect of the net returns from retirement annuity fund member policies and other savings policies have not been met, particularly in the context of early premium cessation.
>
> Whereas the members of the long-term insurance industry wish to meet these expectations by way of the sharing of the costs of early cessation of premiums, taking into account affordability, incentives to save, financial stability and the interests of existing policy holders."

[19] By the very *verba ipsissima* thereof, the statement of intent is intended to address the problems highlighted by this tribunal as regards "early termination values" not only in retirement annuity funds but also in all savings products offered by life assurers. Thus the *Minimum Standards* for which the statement provides are said to apply to retirement annuity funds, endowment policies, life policies primarily intended for savings, and reversionary bonus products (see paragraph 2 of statement of intent). Policies intended primarily for risk benefits are expressly excluded.

[20] In paragraph 4.1 of the statement, early termination values are said to include those arising by reason of reduction of contributions (as in this case); cessation of contributions (as in this case); reduction in retirement age; transfer of the underlying policy (as is sought by the complainant in this case); surrender of the underlying policy; and lapsing of the underlying policy. These are all issues with which this tribunal has dealt and continues to deal, and in respect of which we have made written submissions to National Treasury.

[21] The statement defines a *Minimum Standard* as a percentage of an underlying policy's "Investment Account". An investment account bears the same

definition as the accumulation account in the policy document in this case (see paragraph [6] above). The *Minimum Standard* in respect of early termination values (as explained in paragraph [20] above) arising between 1 January 2001 and the implementation date of the statement (which has not yet been determined) is prescribed in the statement to be ***at least*** 65% of the accumulation account as at the date immediately preceding the event giving rise to such early termination value (eg. reduction or early cessation of contributions, advancement of retirement date, surrender or lapsing of the underlying policy). This *Minimum Standard* applies also to those underlying policies that have lapsed (that is, those that have been "written off" by underwriters and are no longer on their books). The prescribed *Minimum Standard* in respect of early termination values arising after the implementation date is ***at least*** 70% of the accumulation account.

[22] Paragraph 4.8 of the statement makes it clear that these are *minimum standards* which can be improved upon by life assurers. It provides:

> "It is recognised that these are minimum standards and that each member of the long-term insurance industry is free to apply higher standards of early termination values on a voluntary basis."

[23] But the "top-up" on these *minimum standards* is not the only voluntary aspect of the statement. In fact, implementation of the *minimum standard* itself appears to be voluntary, so that none of the life assurer signatories to the statement are in fact bound by it. Paragraph 4.4 of the statement, dealing with *minimum standards* in respect of early terminations that occurred between 1 January 2001 and the implementation date, opens with the following words:

> "Each member of the LOA shall, *voluntarily and of its own volition* . . . credit the following minimum standards . . . ." (my emphasis)

[24] Paragraph 4.7, dealing with *minimum standards* in respect of early terminations occurring after the implementation date, is to the same effect. However, paragraph 4.9 of the statement leaves the door ajar so that the LOA, National Treasury and the FSB can agree on measures to make these *minimum standards* binding on life assurers before the implementation date. To my knowledge, that

has not yet occurred.

[25] According to Old Mutual the premium reduction charge of R454.43 (which it says represented 3.47% of the accumulation account of R13 059.40) and the charge of R816.05 levied for early cessation of contributions (which Old Mutual says represented 5.21% of the accumulation account of R15 648.23) were both within the parameters of the statement of intent and were such that the policy "*does not qualify for an enhancement* in terms of the Statement of Intent".

[26] This is the approach generally taken by life assurers when the amount of the early termination or reduction charge is less than 35%. But the statement of intent does not say any early termination charge that is less than 35% is permissible. It says 65% of accumulation account is the *minimum* value that a retirement annuity fund member should remain with as an early termination value. Clearly that does not mean that a 35% charge is a threshold below which every early termination charge is permissible. It certainly does not mean that a policy to which a less than 35% early termination charge has been levied ceases to qualify for an enhancement. The statement provides for *minimum* standards

and applies to all retirement annuity fund underlying policies, whether a 1% charge has been levied or a 100% charge has been levied.

[27] This widely held position by life assurers that any charge below 35% of accumulation account is free game is worrying. This is more so given that even these minimum value standards are not yet binding on life assurers and they are theoretically free to deduct from members' values more than 35% in charges for reducing contributions or advancing retirement dates or stopping contributions.

[28] Another worrying development is that the statement of intent appears to be used by life assurers as authority for levying charges on underwritten retirement annuity fund underlying policies which are otherwise not permissible in terms of the policy document, the rules and applicable legislation. Two examples stand out. The first is where an underwriter insists that it is within its rights "in terms of the statement of intent" to reduce the accumulation account by a percentage of a market level adjuster in instances where no provision is made for such a reduction in the policy, rules of the fund or any applicable legislation. The second example is where the underwriter, as in this case, relies

on the statement of intent for levying early termination charges not provided for in the rules, policy or applicable legislation by reason only of those charges being below 35% of the accumulation account. This is an abuse of a measure (with all its flaws, chief among which being that its laudable terms are not at all binding) intended to remedy protracted problems that will continue to plague the industry for many years to come.

[29] It is in my view not correct for Old Mutual to say the statement of intent does not apply on the facts of this case by reason only of the amount of the charge levied leaving the complainant, as life assured, with more than the stipulated *minimum* value.

[30] Of course, this case raises another problem of the exclusion from the ambit of the statement of intent of those who reduced or terminated their contributions *before 1 January 2001*, of whom the complainant is one. Precisely what informed this inexplicable cut-off date, when some of the practices the statement seeks to remedy originated as long ago as 1960, is still a mystery. Recently, and in *Chairman of the Board of the Sanlam Pensioenfonds (Kantoorpersoneel) v The Registrar of Pension Funds* (unreported judgment of

the Pretoria High Court under case number 37577/05, dated 22 September 2006) the court had the following to say about a cut-off date (1 January 1980) set for qualification for surplus entitlement in similar fashion (at paragraph [43] of the judgment):

> "As a matter of fact, that date was seemingly chosen arbitrarily. One may be excused for asking why a former member who left his fund in December 1979 will not be entitled to share in an improper utilisation of an actuarial surplus which occurred in December 1979, assuming subsections (5)(a) and (6) having retrospective effect, whereas a former member who joined the fund in 1981 and who left it in 1982, will benefit from that in terms of the two subsections. This does not seem to be logical or rational."

Similar concerns arise in respect of the cut-off date (1 January 2001) set for application of the statement of intent. There does not seem to be any rationality or logic about it at all.

Contribution Reduction and Early Termination Charge

[31] When the complainant reduced his contributions to SARAF, which in turn reduced premiums to the policy held with Old Mutual, from R103.49 to R70 in October or November 1995, and then stopped paying contributions altogether in April 1996, Old Mutual levied a charge of R454.43 for the reduction of contributions, and R816.05 for the early termination of contributions before the complainant's chosen retirement date of 1 November 2020. The question that arises is whether the levy of these charges is permissible.

[32] This aspect of the complaint – having been raised for the first time in further submissions by the complainant following SARAF's response to the original complaint of transfer – did not form part of the original complaint and so would ordinarily have been disregarded.

[33] However, on 20 February 2006 both SARAF and Old Mutual were invited to make submissions in regard thereto since the subject raised dealt with an issue covered in the statement of intent and by reason of which this matter had been referred back to the parties for a possible settlement. A cursory response came

on the same day from an Andrea Ras, Executive Management Consultant (presumably of Old Mutual) intended by its terms only to impress that the costs charged are "*within the parameters set out in the Statement of Intent*". There was no attempt to point to any legislative provision, policy provision or rule provision that is authority for these charges following reduction or termination of contributions.

[34] Nevertheless, on 19 June 2006 this tribunal again invited Old Mutual to explain, among other things, how the amounts charged for reduction and termination of contributions were calculated. We also requested them to point to any provisions allowing for the levying of such a charge in these circumstances. In an undated letter from a client services manager at Old Mutual, no explanation is advanced as regards how the charges were calculated. All that is said is that the calculation was made "*in accordance with the prescribed actuarial rules*". In the result, both this tribunal and the complainant are still in the dark as regards how the charges have been calculated.

[35] As regards provisions which authorise the levying of these charges, Old Mutual had the following to say in that same undated letter:

> "In view of the fact that a reduction in premiums is an amendment of the policy, *there is no specific provision in the policy which expressly permits a deduction from the Accumulation Account*." (my emphasis)

[36] This concession is premised upon a fallacious inference, with respect, eked out of a lacuna in the policy, that:

> "[because] [t]here is no provision in the policy which permits a reduction in premiums . . . [t]he reduction in the premium therefore constituted an amendment to the policy contract, subject to [Old Mutual's] normal terms and conditions, which in turn is subject to the actuarial rules as required by the Long-term Insurance Act . . . ."

[37] In essence, Old Mutual by its own admission seeks to draw an analogy from a set of circumstances not covered by the terms of the policy. As Old Mutual correctly points out, the policy makes no provision for "early termination charge" or "premium reduction charge" (terms by which the charges levied by Old Mutual in this case are commonly known in the retirement industry).

Neither do the rules of SARAF. The Supreme Court of Appeal in *Tek Corporation Provident Fund and Others v Lorentz* 1999 (4) SA 884 (SCA) captured this practice in the following opening remarks (at paragraph [1] of the judgment):

> "Simple-sounding catch-phrases designed to capture elusive concepts in a few easily remembered words are useful in daily discourse but they have their dangers. They may mask the complexity of the concepts or provide a springboard for leaps into the drawing of inaccurate or fallacious analogies."

[38] The court continued in paragraph [28] in these words:

> "An unavoidable consequence of the absence of appropriate provisions was that counsel for respondent were constrained to rest their argument upon what they described as analogous provisions in the rules which, so it was said, gave 'an indication' as to what should be done in this admittedly different situation. In my opinion there are serious conceptual difficulties in the way of such an approach. What the trustees may do with the fund's assets is set forth in the rules. If what they propose to do (or have been

> ordered to do) is not within the powers conferred upon them by the rules, they may not do it."

[39] Old Mutual is not at liberty to levy charges which, by its own admission, are not provided for in the policy.

[40] There is another argument which in my view does not withstand scrutiny. Old Mutual submits that any "Fund Member policy" is subject to the provisions of the Long-Term Insurance Act (52 of 1998) which, among other things, stipulates that an insurer may not make a distinction between the premiums, benefits or other values of different long-term policies unless the statutory actuary is satisfied that the distinction is actuarially justified. This is a provision contained in section 46(b) of that Act.

[41] This submission is open to question in a number of respects. Firstly, it is not clear to me how section 46(b) of the Long-Term Insurance Act justifies the levy of a charge by reason only of a member reducing and subsequently stopping contributions in circumstances where the policy makes no provision for such a charge. Second, since the provision aims to *protect* policyholders (and not

penalise them for doing what is admittedly not covered by the terms of the policy) it is not clear how reliance on it can advance Old Mutual's case. Third, I have no reason to believe that this provision was intended for the circumstances here in issue. What does the distinction between premiums of different long-term policies have to do with a member who reduces his own contributions, by reason of which the fund in turn reduces premiums in respect of a policy in which the member is a life assured? Fourth, there has been no submission from SARAF's statutory actuary to indicate whether he or she considers the reduction and cessation of contributions or premiums in this case "unjustified". So how did Old Mutual arrive at the conclusion that such reduction and cessation is impermissible under section 46(b)?

[42] Fifth, what is a "Fund Member policy", and are we here concerned with one? The Long-Term Insurance Act defines no such animal. It defines a "fund policy" as

> "a contract in terms of which a person, in return for a premium, undertakes to provide policy benefits for the purpose of funding in whole or in part the liability of a fund to provide benefits to its members in terms of its rules,

other than such a contract relating exclusively to a particular member of the fund or to the surviving spouse, children, dependants or nominees of a particular member of the fund; and includes a re-insurance policy in respect of such a contract" (my emphasis)

[43] As the policy here in issue relates exclusively to the complainant (as the life assured), which is expressly excluded from the definition of "fund policy", it seems to me Old Mutual's reliance on provisions of the Long-Term Insurance Act that are intended for application to fund policies is misplaced. By contrast, if the policy here in issue is indeed a "fund policy" as defined, then it would seem that the provisions of section 52 of the Long-Term Insurance Act can have no application to it since it is expressly excluded. In the circumstances, Old Mutual needs to decide whether its case is that policies held by retirement annuity funds are fund policies – in which case the "paid-up" and lapse" provisions of section 52 (and reflected in clause 7 of the policy) will find no application – or whether such policies fall within the express exclusion in the definition of "fund policy" – in which event section 52 (but not section 46) finds application. It cannot at once paddle two canoes.

[44] Assuming that the policy here in issue is not a fund policy, the provisions of section 52(3) of the Long-Term Insurance Act on which Old Mutual relies would in my view still not justify the levy of a charge upon the reduction and cessation of premiums in circumstances where the complainant (or even the board of SARAF comprising Old Mutual employees) was not forewarned in clear and unambiguous terms (as section 62(2)(c) of the Long-Term Insurance Act requires) of the legal consequences of reducing or stopping contributions.

[45] There is one last aspect about this leg of the complaint that requires consideration. Because the event giving rise to this aspect of the complaint occurred in 1995 and 1996, more than three years before the complaint was lodged in 2005, it is time barred within the meaning of section 30I(1) of the Pension Funds Act, and I am ordinarily precluded from dealing with it. However, section 30I(3) of the Act confers upon the adjudicator a discretion, on good cause shown or of his own motion, either to condone late lodgement of a complaint or to extend the period for filing of a complaint. The adjudicator has discretion to extend the period either before or after expiry of the three year period prescribed for the lodgement of a complaint.

[46] The Supreme Court of Appeal has pronounced upon the standard that must be met for condonation to be granted in circumstances of cases like these. In *Melane v Santam Insurance Company Ltd* 1962 (4) SA 531 (A) the court said (at 532B-E):

> "In deciding whether sufficient cause has been shown, the basic principle is that the Court has discretion, to be exercised judicially upon a consideration of all facts, and in essence it is a matter of fairness to both sides. Among the facts usually relevant is the degree of lateness, the explanation therefor, the prospects of success, and the importance of the case. Ordinarily these facts are interrelated: they are not individually decisive, for that would be a piecemeal approach incompatible with a true discretion, save of course that if there are no prospects of success there would be no point in granting condonation. Any attempt to formulate a rule of thumb would only serve to harden the arteries of what should be a flexible discretion. What is needed is an objective *conspectus* of all the facts. Thus a slight delay and a good explanation may help to compensate for prospects of success which are not strong. Or the importance of the issue and strong prospects of success may tend to compensate for a long delay. And the respondent's interest in

finality must not be overlooked."

[47] While the cause of complaint arose in 1995 and 1996, and the complaint was received only in August 2005, I am satisfied that strong prospects of success and the importance of the issue raised tends to compensate for the delay. The issue of life assurers who underwrite retirement annuity funds levying a charge when a member either reduces or stops contributions altogether (and, indeed, levying a charge in respect of <u>both</u> reduction and cessation where a member, as in this case, does both) has been and continues to be one of the most common complaints received and adjudicated by this tribunal. Between 1 April 2005 and 31 March 2006, 96 out of 137 retirement annuity fund issues raised in complaints adjudicated during that period related to this issue. The charge levied upon cessation of contributions accounted for 69 determinations; the reduction of contributions charge accounted for 18; and 9 determinations dealt with complaints in relation to the levying of a charge upon a member advancing retirement age. Most complaints received by this tribunal on retirement annuity funds continue to be in relation to the levying of charges upon reduction and cessation of contributions.

[48] Considerations of fairness to both sides have also played a role in my decision to condone the delay in lodging this aspect of the complaint. I say so because neither SARAF nor Old Mutual has been prejudiced by the late lodgement. This is borne out by their not taking issue with the delay. They have also been able to retrieve the documents relevant for the investigation and adjudication of this complaint. Their recounting of the facts (complete with documentary evidence) demonstrates clearly that they have not been unduly prejudiced by the delay.

[49] In the result, the only appropriate course to take is to order a reversal of the charges as I could not find any provision in the rules, policy document or applicable legislation that authorises the charging of fees by reason only of the reduction or early termination of contributions.

Transfer of Total Assets in Approved Retirement Annuity Fund to Another

[50] With a view to obtaining a broader perspective on this issue, I sought written submissions from the South African Revenue Service and the Competition

Commission on specific questions. They have been joined, pursuant to section 30G(d) of the Pension Funds Act, as third and fourth respondents herein respectively as I consider that they have a direct and substantial interest in this aspect of the complaint.

[51] In its discussion paper on *Contractual Savings in the Life Insurance Industry* released in March 2006, National Treasury commented on the effect that the lack of transferability of interests in retirement annuity funds has on competitiveness in the retirement industry in these terms:

> "The fact that independent research shows that overall fees in the retirement annuity market are high by international standards, suggests that one possible reason for the perceived lack of effective competition is that disclosure and transferability itself are not as effective as they could be in promoting competitiveness." (paragraph 5.2.2)

[52] One of the stated objectives of the Competition Act, 89 of 1998, is "*to provide consumers with competitive prices and product choices*". Such an objective is clearly not achievable if consumers are hindered in their ability to choose where

to invest their money for retirement purposes, or move between retirement annuity funds, whether such choice is informed by cost, product range, investment performance or whim. The complainant wants to sever all ties with both SARAF and Old Mutual because he considers investment performance at Old Mutual to be "very poor". Whether that submission is factually correct or not is in my view immaterial. In any event, neither SARAF nor Old Mutual have disputed that the returns on the investment here in issue are poor, whether on their own or as compared to those of the company to which the complainant wants to transfer his total interest in SARAF.

[53] He also considers the costs levied by Old Mutual, first for reducing his contributions and then again for ceasing contributions altogether, as being unjustified. Why then should Old Mutual and SARAF hinder him in his choice of a retirement annuity fund he considers to be competitive not only in price but also in returns and product range?

[54] Section 5(1) of the Competition Act prohibits agreements between a company, on the one hand, and its customers on the other, that have the effect of "*substantially preventing or lessening competition in a market*", unless either

party can prove that any technological gain, efficiency or other pro-competitive gain resulting from such agreement outweighs that effect. Having been invited to do so, neither SARAF nor Old Mutual considered it necessary to file written submissions in response to the Competition Commission's submission. The Competition Commission made the following written submission on the issue of the prevention or lessening of competition:

> "Restrictions that lock in customers also raise significantly the cost to consumers of switching to more competitive alternatives. This is clearly contrary to the competition policy objective of providing consumers with competitive prices and product choices. Therefore, the Commission strongly advocates against any artificial restrictions that unnecessarily or unreasonably lock customers in to long-term contracts."

[55] Old Mutual will no doubt argue that it has no agreement with the complainant but in my view that would be a "form over substance" argument. In truth, the complainant is Old Mutual's customer since he is the life assured in one of Old Mutual's policies – policy number 5122291 which in clause 16 locks the complainant in the policy until he becomes entitled to an annuity, that is, until

he turns 65 some 14 years hence.

[56] In any event, to the extent that SARAF's liability to its members is limited to amounts payable in terms of the policy held by SARAF with Old Mutual, the terms of the policy agreement form part of the rules by way of incorporation by reference. Thus, Old Mutual is also subject to the rules that govern the relationship between the complainant and SARAF.

[57] I am not aware of any pro-competitive gain that could result from locking members of underwritten retirement annuity funds in long-term policy agreements. SARAF and Old Mutual have advanced no argument in that regard, and the complainant clearly does not believe there is any pro-competitive gain to be had by his being locked into a poorly performing policy.

[58] It is trite that the prohibition placed by life assurers against members of underwritten retirement annuity funds transferring their total interest in those funds to other approved retirement annuity funds of their choice *prior to retirement* substantially prevents and lessens competition in the retirement annuity market in at least two respects. First, members have no freedom to

move their retirement investments to other approved funds with lower costs, better product choices and investment returns. Second, competitors are locked out of the market in respect of members who in any event want to take their business away from poorly performing funds to competitors. This practice strikes at the very heart of the competition law policy objective and it is a wonder how it can still remain uncorrected some eight years after the Competition Act came into effect.

[59] Matters are exacerbated by provisions in the rules of SARAF to the effect that a member may transfer his total interest therein to another approved retirement annuity fund only within two months of the payment of an annuity being due to him (rule 2.3(f)) or from the date on which an annuity is due to commence (rule 4.2.3). These provisions are a direct affront to the clear intention with which Parliament enacted paragraph (b)(xii)(bb) of the definition of 'retirement annuity fund' in the Income Tax Act in 1998 expressly to allow such transfer "*prior to the member becoming entitled to the payment of an annuity*". On the facts of this case, this means the complainant will have to endure another 14 years' agony of an acrimonious marriage while his retirement investment is whittled away in unexplained "actuarially calculated" charges.

[60] As this practice of locking members in a retirement annuity fund policy, beyond even the statutorily prescribed minimum retirement age of 55, has the effect of excluding or impeding competitors or potential competitors from expanding within or entering the retirement annuity market, it constitutes an "*exclusionary act*" within the definition of that term in the Competition Act. As such, Old Mutual has the power to exclude competition in respect of members of SARAF (reputed to have the largest membership among retirement annuity funds in South Africa), and to control the charges it levies because of the monopoly it has on the information it uses to calculate those charges. The presence of these two factors means that Old Mutual is a "*dominant firm*" within the meaning of that term in section 7 of the Competition Act. As a *dominant firm*, it is prohibited from engaging in *exclusionary acts* of the kind here in issue, unless there is some pro-competitive gain to be had by doing so (see section 8(c) of the Competition Act). I am not aware of any such gain nor did Old Mutual point me to any.

[61] In short, it is my view that the practice of disallowing members of SARAF from transferring their total interest therein to other approved retirement

annuity funds of their choice before becoming entitled to the payment of an annuity is in contravention not only of the letter but also of the spirit of the Competition Act.

The Income Tax Act

[62] In order for a retirement annuity fund to be approved for income tax purposes (or retain its approval status for each of subsequent years of assessment) it must satisfy a number of requirements set out in the Income Tax Act, 58 of 1962. Failure to meet these requirements does not result in the fund losing its legal status as a pension fund organisation. It just loses its income tax status meaning, among other things, that any contributions made to it by members are not deductible for income tax purposes in the hands of its members.

[63] Of particular relevance on the facts of this case is the requirement that the rules of the fund must provide:

> “(xii) that save-

(aa) . . .

(bb) for the transfer of any member's total interest in any approved retirement annuity fund into another approved retirement annuity fund prior to the member becoming entitled to the payment of an annuity,

no member's rights to benefits shall be capable of surrender, commutation or assignment or of being pledged as security for any loan"

[64] A number of things are clear from this provision. First, its clear purpose is to protect members' benefits from creditors (except, of course, in instances contemplated in section 37A of the Pension Funds Act as regards maintenance and income tax; instances of proven dishonest conduct resulting in quantified loss to an employer as contemplated in section 37D of the Pension Funds Act; or where the member owes money to the fund in respect of a home loan as contemplated in section 19(5) of the Pension Funds Act read together with section 37D of that Act). Second, transfer of members' total interest in an approved retirement annuity fund to another is *permissible* even *before* the member concerned becomes entitled to payment of an annuity. Third, the transferability of total interest in one approved retirement annuity fund to

another is not a provision that must be compulsorily contained in the rules of the fund for it to retain its income tax status.

[65] SARAF submits that its "understanding" of this provision is that transfer of a member's total interest is permissible "*only if such transfer is provided for in the rules of the relevant funds*". It then concludes that because the rules provide for transfer only in the circumstances set out in Rule 2.3(f) (that is, within two months of retirement), transfer of the complainant's total interest at age 51 (whereas his chosen retirement age, at which he will become entitled to payment of an annuity, is 65 years) is impermissible.

[66] Retirement annuity funds, like occupational pension funds, are governed not only by their rules but also by relevant legislation and the common law (see *Tek Corporation Provident Fund and Others v Lorentz* 1999 (4) SA 884 (SCA) at 894B-C; *Mostert NO v Old Mutual Life Assurance Company (SA) Ltd* 2001 (4) SA 159 (SCA) at paragraph [30]). When paragraph 6 of the Second Schedule to the Income Tax Act was amended in 1992 (by Act 141 of 1992) to exempt from income tax transfers from one approved retirement annuity fund to another, thereby acknowledging that such transfers are permissible, the definition of

'retirement annuity fund' nevertheless remained prohibitive of such transfers. This was clearly an inadvertent omission. In order to correct that anomaly, it then became necessary to introduce paragraph (b)(xii) to the definition (by Act 30 of 1998) expressly providing for the permissibility of such transfers "*prior to the member becoming entitled to the payment of an annuity*". As will become apparent, it is not open to the trustees or Old Mutual (or any other underwriter of retirement annuity funds) in drafting (or considering an amendment to) the rules of SARAF to contract out, as it were, of the laws of the country by introducing burdensome conditions to retirement annuity fund transfers that seek to circumvent clear legislative intent. The clear purpose of paragraph (b)(xii)(bb) of the definition of 'retirement annuity fund' is to enable members of retirement annuity funds to transfer their total interest in approved retirement annuity funds to other approved retirement annuity funds of their choice *prior to becoming entitled to the payment of an annuity* (that is, prior to either chosen retirement date or age 55) without incurring an income tax liability.

[67] Moreover, that the Income Tax Act does not permit payment of an annuity prior to a member reaching the age of 55 does not detract from the legislative intent in paragraph (b)(xii)(bb) of the definition of 'retirement annuity fund'.

An annuity is payable by a retirement annuity fund only upon retirement or permanent disability or death. When a member seeks to transfer his total interest in an approved retirement annuity fund to another, he does not thereby seek payment of an annuity in breach of Income Tax Act provisions.

[68] For these reasons, I cannot accept SARAF's argument that the complainant's request for a transfer of his total interest in that fund to another approved retirement annuity fund *prior to retirement* cannot be acceded to by reason of there being no provision in the rules for such transfer. There are other reasons that render SARAF's argument untenable and I now deal with those.

Duties of the Board of Management

[69] Section 7C of the Pension Funds Act codifies the common law fiduciary duties owed by the board of management of a fund to members. The section requires the board to direct, control and oversee the operations of the fund in accordance with the applicable laws and the rules of the fund, to take all reasonable steps to ensure that the interests of members in terms of the rules of the fund and the

provisions of this Act are protected at all times, and to act with due care, diligence, in good faith and avoid conflicts of interest.

[70] The rules of SARAF (8.1 and 8.4 (a) – (d)) incorporate the above statutory duties. Moreover, rule 8.4 (e) provides that the board shall:

> "have and be entitled to exercise all powers, rights and privileges vested upon it in accordance with the provisions of these Rules. Such powers, rights and privileges shall be exercised in conformity with the [Pension Funds] Act, the Income Tax Act, the Financial Institutions (Investment of Funds) Act, 1984 (as amended) and any other relevant legislation and with any ruling laid down by such authorities as the REGISTRAR [of Pension Funds] and the REVENUE AUTHORITY;"

[71] The importance of the rules complying with legislation is fortified by rule 8.4(j) which places an obligation on the board to ensure that the rules of the fund comply with the Acts of Parliament outlined in rule 8.4(e) and any other relevant legislation and rulings issued by the Registrar of Pension Funds and the South African Revenue Services.

[72] In terms of the Financial Institutions (Investment of Funds) Act 39 of 1984 and its successor, the Financial Institutions (Protection of Funds) Act 28 of 2001, a pension fund is a "financial institution" as defined. Section 2 of these Acts sets forth very stringent requirements for persons in a trust relationship with financial institutions (such as a member of a board of management), requiring the board members when dealing with fund assets to observe the utmost good faith and exercise proper care and diligence.

[73] Rule 8.2 regulates the appointment of trustees in terms of which all but one of the trustees is appointed by the underwriter, Old Mutual. At least one of the trustees is to be an independent trustee appointed by the existing board of trustees and he or she must be approved by the Financial Services Board and cannot be an employee of the underwriter or under the control of the underwriter (rule 8.2.1).

[74] Once a person is appointed as a trustee regardless of whether the person is an employee of the underwriter, the above-mentioned duties are applicable and thus the trustee must act in the best interests of the fund and its members and

not the underwriter. In *Central Retirement Annuity Fund v Adjudicator of Pension Funds and Others* [2005] 8 BPLR 655 (C), Davis J (in whose judgment Le Grange AJ concurred), although dealing with the issue of illustrative values, commented on the duties of retirement annuity fund trustees as follows (at 664C – E):

> "In my view, it is incumbent upon the management committee [board of trustees] of Applicant to take reasonable steps to protect the interests of members of the Fund. Hence it is not open to Applicant to contend that it was no more than a passive conduit between its members and Sanlam Life. It has a duty to act diligently to ensure that members' interests are protected. . . ."

[75] When the Income Tax Act was amended in 1998 to allow for transfers between approved retirement annuity funds *prior to age 55*, the board of trustees of all such funds had a duty to consider whether the rules should be amended to allow for such transfers. In terms of rule 7.1, only the board of trustees has the right to amend the rules of the fund and such amendment must be approved by the South African Revenue Service and the Registrar of Pension Funds.

[76] When determining whether the rules should contain such a provision, the board of trustees must act in the best interests of the members of the fund. Now, there can be no doubt in my view that absence of a rule allowing transfer prior to retirement, and instead locking in members until age 55 or chosen retirement date (whichever occurs *last*), is clearly in the interests not of members but of the underwriter of the fund. The implications of that are that the trustees of SARAF are failing to comply with their various statutory duties by not having such a rule. The Pension Funds Act, Competition Act, and Income Tax Act are all clear in their provisions as have already been discussed. It is the trustees' duty now to ensure that the rules of SARAF comply with those provisions.

[77] The Competition Commission strongly advocates against any artificial restrictions that unnecessarily or unreasonably lock customers into long-term contracts. National Treasury is also of the view that lack of competition may be a result of ineffective transferability among retirement annuity funds. The Income Tax Act allows transfer prior to retirement. In these circumstances, I can find no reasonable cause for locking members into a retirement annuity fund (especially where a member is dissatisfied with investment returns on his

retirement investment).

[78] Allowing members the right to move between retirement annuity funds (which they voluntarily joined in the first instance as opposed to occupational pension and provident funds where one is in many instances obliged to join the fund upon the commencement of employment) surely must be in the best interest of fund members, especially where they are unhappy with the existing fund's costing structures, management of the fund and investment returns. It will also serve as an incentive to the board and the underwriter to perform at a level which is satisfactory to the members. The absence of a transfer rule clearly protects the interests of the underwriter. As stated above, even though appointed by underwriter (and in many instances also employees of the underwriter), the trustees cannot serve the interests of the underwriter at the expense of the members.

[79] Owing to the failure of the fund to have an empowering transfer rule, the complainant has sustained prejudice in that he cannot transfer to another approved fund of his own choice. The appropriate relief is to order the fund to submit a rule amendment to the Registrar of Pension Funds allowing for the

transfer of members to other retirement annuity funds prior to retirement age. Should the Registrar be satisfied with the amendment (having regard to the criteria outlined in section 12 of the Act) and approve the rule amendment, the complainant may move his assets in SARAF to another approved retirement annuity fund. While I am alive to the challenge facing the Registrar of Pension Funds in expeditiously considering applications for rule amendments, I would urge him to give this matter his urgent consideration since the complainant's retirement investment appears to be losing value for each month that goes by.

The Constitution

[80] The Constitution of the Republic of South Africa, Act 108 of 1996, ("*the Constitution*") entrenches in the Bill of Rights chapter "the right to freedom of association" (see section 18 of the Constitution). The refusal by SARAF and Old Mutual to allow the complainant to transfer his total assets in SARAF to another approved retirement annuity fund of his choice prior to his entitlement to the payment of an annuity (which is set to occur only 14 years from now when he turns 65) violates that right. I am not aware of any justification – and

SARAF and Old Mutual have advanced no plausible justification – for the limitation of that right in the circumstances of this case, particularly where the complainant considers himself "*being ripped off*" and that the Old Mutual policy yields "*very poor returns*" for his retirement savings.

[81] Nevertheless, since the constitutionality of the refusal to allow a transfer at this stage has not been raised by the complainant, I shall not make a finding on that issue.

Finding on the Transfer Question

[82] In the result, the complaint in relation to the transfer of the complainant's total assets in SARAF to another approved retirement annuity fund of his choice must also succeed, subject to the rule amendment being approved by the Registrar of Pension Funds. It is my view that a section 14 certificate (in terms of section 14(1)(e) of the Pension Funds Act) would not be required to effect such a transfer because the section was in my view, and on a proper construction of all its provisions, never intended for a transfer of the kind here

in issue.

Jurisdiction

[83] Since no issue has been taken with the jurisdiction of this tribunal to investigate and adjudicate upon this complaint, it is unnecessary for me to concern myself with that question.

Relief

[84] I thus make the following order:

[84.1] The late lodgement of the complaint relating to the levy of charges upon reduction and cessation of contributions is condoned;

[84.2] It is declared that Old Mutual had no authority to deduct amounts from the accumulation account in relation of the policy here in issue by reason

only of the complainant reducing and subsequently terminating contributions to SARAF.

[84.3] Old Mutual is ordered within six weeks from the date of this determination to re-calculate the accumulation account as at the effective date of the charges levied upon reduction of contributions and cessation thereof, respectively, as if such charges had not been levied;

[84.4] The board of trustees of SARAF is hereby directed to submit a rule amendment (in terms of rule 7.1) to the Registrar of Pension Funds allowing for the transfer of members to other approved retirement annuity funds prior to age 55, within six weeks of the date of this determination.

[84.5] Having performed the re-calculation in paragraph [84.3] above, and upon registration of the transfer rule referred to in paragraph [84.4], SARAF is further ordered to transfer the complainant's total interest in SARAF to another approved retirement annuity fund of his choice within two weeks of the registration of the rule.

DATED AT JOHANNESBURG THIS DAY OF 2006.

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VUYANI NGALWANA
PENSION FUNDS ADJUDICATOR

Appearances
All parties not represented.

cc: The Principal Officer
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SECTION 30M FILING: MAGISTRATES COURT