

High Court Actions Concerning Unfair Retirement Fund Rules

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1. Introduction

Section 13 of the Pension Funds Act, 1956, provides that -

“Subject to the provisions of this Act, the rules of a registered fund shall be binding on the fund and the members, shareholders and officers thereof, and on any person who claims under the rules or whose claim is derived from a person so claiming.”

This section may be disheartening for members faced with unfair pension fund rules. Many believe that the section would defeat any claim they may bring against the fund concerning the application of those rules and so they turn instead to the road more travelled to the CCMA. They hope that, by attributing to their employer the failure of the board to ensure that the rules of the fund are fair, they may bring their dispute with the fund under the jurisdiction of the CCMA.

While there are pension fund-related claims which may be referred to the CCMA, its jurisdiction is limited to disputes between employers and employees. It would not have jurisdiction to determine a dispute between, for example, the pensioner members of a

fund and its management board concerning the failure of the board to amend the rules to ensure that they are fair. Regrettably the jurisdiction of the Pension Fund Adjudicator is also quite limited. While, in regard to complaints referred to him the Adjudicator has the power to make any order which another court of law could make, the scope of the Adjudicator's jurisdiction is quite limited. It is restricted to the adjudication of complaints "relating to the administration of a fund, the investment of its funds or the interpretation and application of its rules..."¹ There is, of course, a question whether the words "application of its rules" means how the rules are applied or whether they are applied or both. No doubt John Murphy will have occasion to decide the matter.

I have asked to share with you some thoughts on legal action which may be brought in the High Court regarding unfair retirement fund rules. These thoughts, it must be said, are nothing more than that. It is to be hoped that creative litigation will soon give these and other ideas a proper airing in the High Courts and so will contribute to the development of what is a highly under-developed area of our law.

The actions contemplated in this paper would be brought against the board of management of the fund, for it is the board which has the power to amend the rules of the fund even if power is sometimes subject to the consent of the participating employers in a fund. My central proposition is that the board is legally obliged to ensure that the rules of the fund are fair more particularly in that they protect the interests of the members of the fund and do not unfairly discriminate against a member or a category of members of a fund.

¹ Taken from the definition of "complaint" in the Pension Funds Act, 1956.

2. What Unfair Rules could be the Subject of an application to the High Court?

As both Kobus Hanekom and Peter Strasheim² (will have mentioned, the traditional rule incorporating a penalty on the early withdrawal of a member from a fund is an unfair one. Although it is true that pension funds are established to provide benefits on retirement³, this is not the whole picture. Membership of occupational pension funds is, in most cases, a condition of employment and the contributions paid to the funds by employers in respect of their employees who are members of the fund are a form of pay.⁴

Comment [RHunter1]: Yes

The fact that the contributions to a pension fund constitute a form of pay does not mean that a member has a vested right in those contributions after they have been paid to the fund. On the contrary, the assets of a fund belong to it alone⁵. However, the legal position does nothing to diminish the feelings of shock and resentment that many members feel when they see how little they receive on their early withdrawal from a pension fund. In many cases the member would have received a better return had he or she invested his or her own contributions in a Post Office savings account. The employer, on the other hand, often benefits from the early withdrawal of a member because the difference between the value of the assets held in respect of the member and the value of the monies paid to the member may be used to reduce the employer's liabilities in connection with the fund. In effect, a member is compelled to divert part of his or her earnings to a fund for which he or she will only derive a benefit if he or she remains employed until retirement, even if he or she cannot exclusively control the

² Co-panellist at the conference.

³ That object is an essential element of the definition of "pension fund organisation" in the Pension Funds Act. Section 10 of the Act, furthermore, provides that -

"No registered fund shall carry on any business other than the business of a pension fund. Provided that the registrar may approve of a fund carrying on such other business on such conditions and for such period as he may determine if the registrar is satisfied that this is necessary in order to safeguard an investment made by the fund."

⁴ As Lord Pearce pointed out in his judgment in British case Parry v Cleaver -

"What the employer pays actually or notionally to a pensions fund is part of the total cost which he is prepared to pay in respect of the employee's service...[I]n my view the employer's contributions are earned by the employee's service just as much as those which the employee himself contributes, and I can see no justification for a difference in principle between the two contributions."

Lord Pearce's views were echoed by Brandon J in The Halycon Skies when the latter said that the "employer's contributions to such a fund, as well as the employee's contributions, can properly be regarded as part of the employee's total wages in the broadest sense of the word." For a more comprehensive exposition of the proposition that the contributions to a pension fund constitute a form of pay, see my unpublished research report entitled "Inequities and Illegalities in Occupational Retirement Funding" dated November 1993.

⁵ Section 5 of the Pension Funds Act.

fulfilment of that condition.

While the feelings of members who are subject to early withdrawal penalties do not themselves found a claim in law, the facts and circumstances giving rise to those feelings may well do so. Those facts and circumstances include the unfair rules of the fund and the role of the members of the fund's board of management in maintaining the unfair regime through their failure to fulfil their fiduciary obligations by changing the rules.

3. The Fiduciary Duties of the Management Board of a Pension Fund

Some of the fiduciary duties of the members of the management board of a pension fund are set out in the Pension Funds Act. Section 7C(1) provides that -

“The object of a board shall be to direct, control and oversee the operations of a fund in accordance with the applicable laws and the rules of the fund.”

Section 7C(2) provides that -

“In pursuing its object, the board shall –

- (a) take all reasonable steps to ensure that the interests of membership in terms of the rules of the fund and the provisions of this Act are protected at all times especially in the event of an amalgamation or transfer of any business contemplated in section 14, splitting of a fund, termination or reduction in contributions to a fund by an employer, increase in contributions of members and withdrawal of an employer who participates in a fund;
- (b) act with due care, diligence and good faith;
- (c) avoid conflicts of interest;
- (d) act with impartiality in respect of all members and beneficiaries.”

The fiduciary duties of a management board extend far beyond those set out in the Act. Our common law (that is, judge-made law) imputes to certain offices, such as the office of a director of a company, a trustee of a trust, the attorney of a client, and the agent of a principal fiduciary obligation simply because of the nature of the office⁶. The office must be one in which the holder of the office has an obligation to act for the benefit of another and for that purpose is granted discretionary powers the application of which will affect the interests of the beneficiary. The fiduciary duties include the

⁶ *Conze v Masterbond Participation Trust Managers (Pty) Ltd* 1996 (3) 976 (C).

obligation of loyalty to the beneficiaries and the duty to disregard the interests of others save to the extent that their interests coincide with those of the beneficiaries.

Included in the powers of the members of the board of management of a pension fund is the power to amend the rules of the fund. To the extent that the board may amend the rules in order to ensure that the rules are in the best interests of members, they must exercise that power because a failure to do so would constitute a failure to act in accordance with their fiduciary obligations. It would also constitute a failure to comply with the Pension Funds Act, section 7D(f) of which provides that the duties of a board shall be to, *inter alia* –

“ensure that the rules and the operation and administration of the fund comply with this Act, the Financial Institutions (Investment of Funds) Act, 1984 (Act No. 39 of 1984), and all other applicable laws.”

It seems clear that, if a board did not ensure the removal of a rule which unfairly discriminates against, for example, members who are compelled to withdraw from the fund prior to retirement, whether on grounds of dismissal, retrenchment or disability, it would be failing in its duty to “act with impartiality in respect of all members and beneficiaries.”

Let us take the case of the retrenched employee. If he or she is not granted the opportunity to defer his or her pension benefits in the fund and is instead given a withdrawal benefit which is less valuable than his or her actuarial reserve (in the case of a defined benefit fund) or fund credit (in the case of a defined contribution fund), he or she will suffer a penalty as a result of the early termination of his or her membership. That discrimination cannot be justified on the basis that the purpose of a pension fund is to pay benefits on retirement.⁷

By effectively confiscating the difference in the value of the assets held in respect of the member as at the date of the termination of his or her membership for the purpose of providing the benefits for which the fund was established and the value of the withdrawal benefit, the board penalises those who withdraw early because it restricts their ability to apply the balance of the assets to appropriate alternative retirement

⁷ According to the definition of “pension fund organisation” in the Pension Funds Act, the object of a fund is one of –

“providing annuities or lump sum payments for members or former members of such association upon their reaching retirement dates, or for the dependants of such members or former members upon the death of such members or former members.”

funding arrangements. This is particularly galling when the member is compelled to withdraw through no of his or her own.

But what of the employee who is dismissed? Should the early withdrawal penalty not be regarded as one of the punishments facing an employee who is dismissed for misconduct or poor performance? I think not. As De Kock SM said in *Van Coppenhagen v Shell and BPSA Petroleum Refineries (Pty) Ltd*⁸, an employer to which is granted discretionary power in terms of the rules of a pension fund must use them for the purpose for which they were intended; to ensure the financial soundness of the fund. They are not intended to be used as weapons against the employee. The reason for the early withdrawal of a member should not be relevant to the fund because it is not an instrument of the employer. Thus, if a board faced with a pension fund rule which discriminates between members who withdraw early on the basis of the reason for their early withdrawal fails to amend the rule to remove the discrimination, it will be failing in its duty to “act with impartiality in respect of all members and beneficiaries. It would be failing in that duty too if it failed to amend a rule which provides that on transfer of a group of members out of the fund to another fund, nothing more than the value of their actuarial reserves in the fund will be transferred. As Lord Justice Dillon said in the British case of *Stannard v Fisons Pension Trust Ltd*⁹ in which Lord Justice Dillon said -

“If [the members of the board] decide to make a transfer they have to consider whether they are acting fairly as between those who will become members of the associated scheme and those who will remain members of the Fisons pension scheme... they will... in each case need to feel satisfied that the amount to be transferred is fair each way. In each case the transferring members and the members who remain are among the trustees’ beneficiaries.”

There are other “applicable laws” with which the board is required to ensure that the rules comply and I turn now to look at those.

4. The Constitution

Section 9 of the Constitution provides, inter alia, that -

“(3) The state may not discriminate directly or indirectly against anyone on one or more grounds, including race, gender, sex, pregnancy, marital status, ethnic or social origin, colour, sexual orientation, age, disability, religion, conscience, belief,

⁸ (1991) 12ILJ 620 (IC) at 627

⁹ [1992] IRLR 27 at 29.

culture, language and birth.

- (4) No person may unfairly discriminate directly or indirectly against anyone on one or more grounds in terms of subsection (3)..."

The provision of the Constitution governing the application of the bill of rights of which the equality clause is a part provides that -

"A provision of the Bill of Rights binds a natural or a juristic person if, and to the extent that, it is applicable, taking into account the nature of the right and the nature of any duty imposed by the right."

It seems clear that from the nature of the right contained in the equality provision, and the wording of the equality clause, that it is applicable to natural and juristic persons including pension funds. Accordingly a pension fund's board is required to ensure that its rules comply with the Constitution.

5. **The Financial Institutions (Investments of Funds) Act**

Section 2 of the Financial Institutions (Investments of Funds) Act 39 of 1984 provides that a director, official, employee or agent of a pension fund shall observe the utmost good faith in controlling and administering a fund and that such persons -

"...shall not...make use of the funds...in a manner calculated to gain directly or indirectly any improper advantage for himself or any other person at the expense of the [fund or a] beneficiary..."

As I have already mentioned, the application of the early withdrawal rule usually has the effect that the participating employer derives some financial advantage from the penalty imposed upon the withdrawing member. In the case of a defined benefit fund, the "withdrawal profit" increases the actuarial surplus, if any, in the fund and, in the case of a defined contribution fund, it is transferred to an "employer protection reserve account" from which is paid the risk and insurance costs of the fund and, in some cases, the employer's contribution to the fund.

The Financial Institutions (Investments of Funds) Act only prohibits the use of the assets of the fund for the "improper" advantage of anyone other than the fund or its beneficiaries. The question is thus - does the granting to the employer of the benefit of the early withdrawal profits amount to the granting of an improper advantage? In my opinion the answer is yes. It is improper to use assets which have been

accumulated for the purpose of providing a fund member with a retirement fund benefit to reduce the financial liability of an employer to make contributions to the fund in respect of other members. It is also the view of Mr Justice Navsa in his judgment in *Lorenz v Tek Corporation Provident Fund and others*¹⁰.

6. The Income Tax Act

Section 1 of the Income Tax Act provides that the Commissioner for Inland Revenue may not approve a fund in respect of any year of assessment unless he is satisfied that the rules of the fund provide -

“... for the administration of the fund in such a manner as to preclude the employer from controlling the management of the fund or assets of the fund and from *deriving any monetary advantage from monies paid into or out of the fund*”;

While the Act does not require that the rules comply with the above, it does impose a severe penalty (non-approval) for non-compliance. It is certainly arguable that this is an “applicable law” contemplated in section 7D of the Pension Funds Act.

7. Legal Action against the Board

There is no penalty imposed in terms of the Pension Funds Act for the non-compliance by a board of the duties set out in the Act. The Act does not even state that non-compliance with sections 7C and 7D constitute criminal offences. There are, however, a couple of actions which may be brought against the management board of a fund by its members in the circumstances contemplated in this paper.

It is irrelevant whether the management board is employer-dominated or is a “stakeholder constituted” board. The fiduciary duties of the members will be the same. As the fiduciary obligations of boards of management are ongoing, the fact that the offending rules have been in existence for more than 3 years will not defeat the claims I will be describing.

7.1 Directory Interdict

An application may be made for an order that the board is directed to amend the rules of the fund to eliminate those provisions which are unfairly discriminatory or

¹⁰ 1998 1 SA 192 W at 225J.

in any other way against the best interests of the members of the fund.

7.2 **Action for compensation**

Legal action may be brought against the fund for compensation for losses sustained by the members as a result of the failure of the fund (embodied in the members of its board of management) to comply with their fiduciary duties to amend the rules. If the members of the board acted in bad faith in refusing to amend the rules, they may be sued in their personal capacity.

I leave you with these ideas and hope that together we can thrash out these and others with a view to finding ways to improve the retirement funding regime in this country in the best interests of those it is intended to benefit. That, surely, is what we are called upon to do and why we established this organisation.