

## Article

1. As the pace at which funds are finalising and submitting their surplus apportionment schemes to the Registrar of Pensions for approval picks up, many trustees are asking whether the Registrar has the power to reject their schemes simply because he may feel that different schemes would be equitable in the circumstances pertaining to them. The Registrar has reportedly told some trustees that he will not accept as equitable the exclusion of former members from the distribution of residual surplus.
2. The purpose of this article is to consider the extent of the power of the Registrar to reject a scheme in the absence of manifest injustice to one or more of the stakeholders.
3. Section 15B(5)(c) of the Act states the following:

“[A]fter deducting the cost of the increases to former members and pensioners in terms of paragraph (b) the balance of the actuarial surplus shall be equitably split between existing members, former members and the employer in such proportions as the board shall determine after taking account of the financial history of the fund: Provided further that the registrar may prescribe certain methods which, if used, shall be deemed to be equitable.

4. This section requires that the trustees take account of the financial history of the Fund but does not require that any split of the surplus be determined on a basis that is logically connected to that financial history.<sup>1</sup>

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<sup>1</sup> This requirement accords with the judgment of Chadwick LJ in *Edge v Pensions Ombudsman & another* [1999] 4 All ER 546 at 565J-566F where he indicated that, in exercising their discretion as to the allocation of surplus, the trustees of a pension fund are required to have regard for all relevant facts and factors, including the financial history of the fund. The judge said the following:

“The right to have the matter properly considered gives rise to the requirement that, if there is an actuarial surplus after providing for the estimated liabilities, the trustees must, in deciding whether or not to increase benefits (and, if so, what benefits), act in a way which appears to them fair and equitable in all the circumstances; and leads to a reasonable expectation amongst beneficiaries.

The obligation to consider, properly, the question whether to increase benefits (and, if so, what benefits) will usually require the trustees to consider (amongst other matters) the circumstances in which the surplus has arisen. In deciding what is fair and equitable in all circumstances, the trustees may be expected to give weight to the claims of those whose contributions are, or will be, the effective source of the surplus. For example, in a pure ‘balance of costs’ scheme, trustees may properly take the view that an actuarial surplus which has arisen through past over funding ought to be reduced by allowing Employers a future ‘contribution holiday’ . . .

In a case where the actuarial surplus arises from prospective over funding by excessive contributions from members in the future, the trustees may properly decide that the fair and equitable course is to reduce those contributions; or increase the benefits of those who will be making future contributions. If, on the other hand, the surplus has arisen through over funding which is plainly attributable to past members’ contributions, the members who have made those contributions will have a strong claim to an increase in benefits . . .

5. While, on the face of it, the section appears to require an equitable split of the surplus on the basis that equity<sup>2</sup> can be objectively determined, there is, of course, no objective standard of equity in these or any other circumstances.<sup>3</sup> What one person may regard as an equitable split of the surplus is quite likely to be regarded by another person as inequitable, particularly if one or both of them is a potential beneficiary of the apportionment.<sup>4</sup>
6. So what must be “equitable” for the purposes of section 15B(5)(c) must be what the trustees regard as equitable, subject only to the rider that what they regard as equitable is not manifestly unjust.
7. Section 15B(9) of the Act states that a scheme for the apportionment of surplus will be of no force or effect unless the registrar is satisfied that the scheme is reasonable and equitable and accords full recognition to the rights and reasonable benefit expectations of existing members and former members in respect of their service prior to the surplus apportionment date.

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The need to consider the circumstances in which the surplus has arisen does not lead to the conclusion that the trustees are bound to take any particular course of action as a result of that consideration. They are not constrained by any rule of law either to increase benefits or to reduce contributions or to adopt any particular combination of options. Nor does the need to consider the circumstances in which the surplus has arisen lead to the conclusion that the trustees are not required to take – or are prohibited from taking – any other matters into account in deciding what course to adopt.”

[Our emphasis]

<sup>2</sup> The word “equitable” is defined in the Oxford English Dictionary Second edition, Volume V, at page 357 as follows:

“In an equitable manner, according to the rules of equity, in a spirit of fairness”.

The word “Equitable” is defined in the same work as -:

“Characterized by equity or fairness; that is in accordance with equity; fair, just, reasonable.”

“Equitable” is defined in *Black’s Law Dictionary*, seventh edition, West Group Publishers at page 558 as follows:

“Just; conformable to principles of justice and right. Existing in equity; available or sustainable by an action in equity, or under the rules and principles of equity.

<sup>3</sup> In the matter of *Adriaens and others vs Langeberg Foods Pension Fund*<sup>3</sup> the adjudicator sought to give some content to the meaning of the word “equitable” in the context of a surplus apportionment when he stated the following:

“In order for the scheme to be reasonable and equitable it should have the qualities of being equal, fair, impartial and even-handed.

To determine what is reasonable and equitable of necessity involves a comparative exercise. In addition to the requirement of reasonable benefit expectation being met, in a fund with a substantial surplus, it is argued, equity requires a transfer not only of assets to meet the benefit expectations, but also a fair and even handed transfer of a portion of the surplus, in an amount of size may be appropriate, having regard to the assets and liabilities of the fund as a whole.”

<sup>4</sup> See, for example, the judgment of the pension funds adjudicator in *Petch v Ellman Plastics Pension Fund & others* [2003] 1 BPLR 4281 (PFA) in which he said the following:

“As I have stressed in my previous determinations, my function is not to impose views and preferences on funds but rather to ensure that a proper decision-making process has been followed and that final decisions taken are not unreasonable and do not unfairly discriminate against any member or group of members. Clearly there is no absolute method of surplus distribution that can be applied in all situations. It is the duty of the trustees to consider the circumstances of their own fund to reach an appropriate decision which is in the best interests of all its members. There will invariably be opposing views in this regard. However, this is not sufficient to set aside a legitimate decision of the trustees.”

8. This section appears to give the registrar the power to refuse to approve a surplus apportionment scheme if it does not accord with what he would regard as an equitable scheme in the circumstances of the fund. However, such an interpretation would render the exercise by the trustees of their independent discretion a meaningless exercise.
9. So the term “equitable” in the context of the registrar’s discretion must be given a more narrow meaning than that which it is conventionally understood to bear and for this guidance may be sought from the decisions of the Chancery Division of the UK High Court, a court which has an “equity” jurisdiction. Decisions by that court are required to be taken with regard to “the rules of equity”. These “rules” are designed not to achieve decisions which are equitable on some objectively determinable basis but instead to minimize the risk of manifest injustice.<sup>5</sup> The test for an equitable distribution is not fairness, then, but proportionality.<sup>6</sup>
10. This notion of equity is akin to the formulation adopted by our South African courts in determining whether or not a decision taken by a decision-maker is reasonable.<sup>7</sup> The test for reasonableness, or variations of it, has been applied to the assessment of decisions taken by retirement fund trustees by the pension funds adjudicator.<sup>8</sup>

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<sup>5</sup> See, for example, the judgment of the England and Wales Court of Appeal in *Murad & Anor v Al-Saraj & Anor* [2005] EWCA Civ 959 (29 July 2005) in which the following was stated:

“While the rule of equity applied in the *Regal* case is a rigid and inflexible rule, historically equity has been able skilfully to adapt remedies against defaulting trustees or fiduciaries so as to meet the justice of the case. One small example of this is the VGM principle. Under this principle, a director ordered to pay compensation for misfeasance to his company in liquidation will not be required to pay amounts which would simply be distributed in the liquidation back to him as, say, a creditor (see for example *Selangor United Rubber Estates v Cradock (No 4)* [1969] 1 WLR 1773). Likewise a court of equity will fix the measure of damages against a defaulting but innocent trustee more leniently than it would otherwise have done: see for example *Shaw v Holland* [1900] 2 Ch 305, 310. Again, courts of equity award simple or compound interest and interest at different rates according to the circumstances of the case (see for example *Wallersteiner v Moir* (No.2) [1975] QB 373). In these ways, equity tempers the harsh wind to the shorn lamb.” [My emphasis].

<sup>6</sup> The test for proportionality is described by de Villiers, JR. in *Judicial Review of Administrative Act in South Africa* at p 203 as follows:

“This principle is usually said to entail three enquiries:

- (a) was the measure in question suitable or effective to achieve the desired aim ?;
- (b) was the measure necessary in the sense that no lesser form of interference with the rights of the person was possible in order to achieve the desired aim (such alternative measure being equally effective to the measure taken) ?;
- (c) does the measure (even though it may be suitable and necessary) not place an excessive burden on the individual which is disproportionate in relation to the public interest at stake ?

<sup>7</sup> See, for example, *Mandela v Minister of Prisons* 1983 (1) SA 938 (A) at 960 A-H in which the court said that a decision is unreasonable if it is manifestly unjust, if it disclosed bad faith, if it involved such oppressive or gratuitous interference with the rights of those subject to them that it could never be regarded by reasonable men as being justified.

<sup>8</sup> See, for example, his determination in *Whitlock-Jones v Old Mutual Staff Retirement Fund* [2000] 6 BPLR 674 (PFA) in which he said:

- 10.1. It is also the test used by the CCMA and our labour courts in determining whether or not a dismissal is fair.<sup>9</sup>
- 10.2. So all that the registrar is required to decide is whether the scheme is reasonable.<sup>10</sup> This interpretation is supported by the provisions of sections 15 (3)(b)(ii) and 15B (9)(b)(ii) of the Act which require that there be submitted together with the trustees' scheme for the apportionment of actuarial surplus certificates by the fund's "former member representative" and by the fund's valuator that, in the opinion of each, the exercise by the trustees of their discretion was "reasonable, taking into account the demands of equity within the bounds of practicality and the circumstances of the fund."
- 10.3. The decision that the trustees take may not be the only reasonable decision that they could take in the circumstances of the Fund but, provided that it is a reasonable decision, neither the registrar nor any special tribunal or court may interfere with it.<sup>11</sup>

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"It is the trustees' discretion that is to be exercised. Except in a case where the discretion has been surrendered to the court, it is not for the judge to exercise the discretion. The judge may disagree with the manner in which the trustees have exercised their discretion but, unless they can be seen to have taken into account irrelevant, improper or irrational factors, or unless their decision can be said to be one that no reasonable body of trustees properly directing themselves could have reached, the judge cannot interfere. In particular, he cannot interfere simply on the grounds that the partiality shown to the preferred beneficiary was in his opinion undue."

See also *Jenkinson v Nedcor Pension Fund* [2001] 9 BPLR 2467 (PFA) (cited above).

<sup>9</sup> See, for example, the judgment of the Labour Appeal Court in *County Fair Foods (Pty) Ltd v CCMA & others* (1999) 20 ILJ 1701 (LAC) in which the court held that a commissioner is only justified in interfering with a sanction where the sanction is "so excessive as to shock one's sense of fairness".

<sup>10</sup> See, however, the judgment of the Supreme Court of Appeal in *Pepcor Retirement Fund & another v The Financial Services Board & another* [2003] 8 BPLR 4977 (SCA) the court said, in relation to the exercise of his discretion in terms of section 14 of the Act (which section states that a scheme for the transfer of business will be of no force or effect unless the registrar is satisfied that the scheme is reasonable and equitable), -

"... if the Registrar were to conclude, in the exercise of the wide discretion conferred on him by section 14(1)(c), that the proposed transaction was neither just nor equitable, because the funding level of the transferring fund considerably exceeded the funding level of the transferee funds and there was a substantial surplus which would remain in the transferring fund, he would be acting fully within his regulatory powers and a court would not on review be able to interfere with his decision simply because it did not agree with it."

The trustees have been advised that the court's statement as regards the wide discretion conferred upon the registrar is not authority for the view that the registrar is entitled to substitute his own decision as to what would be equitable in the circumstances for that of the trustees without being able to demonstrate that the decision was unreasonable.

<sup>11</sup> See the judgment of Sir Richard Scott V-C in *Edge v Pensions Ombudsman* [1998] 2 All ER 547 (ChD):

"Except in a case in which the discretion has been surrendered to the court, it is not for the judge to exercise the discretion. The judge may disagree with the manner in which the trustees have exercised their discretion, but unless they can be seen to have taken into account irrelevant, improper or irrational factors, or unless their decision can be said to be one which no reasonable board of trustees properly directing themselves could have reached, the judge cannot interfere. In particular, he cannot interfere simply on the ground that the partiality shown to the preferred beneficiaries was in his opinion undue [at page 568] . . . . Neither a duty to act impartially nor a duty to act in the best interests of all the beneficiaries describes, in my judgment, the nature of the duty on the trustees when considering what steps to take to deal with the surplus. They had a discretionary power to make amendments to the rules in order to provide additional benefits to members, whether pensioners or still in service. It was within their discretion to provide benefits to members in service to the exclusion of members no

- 10.4. In order that their decision be regarded as reasonable, it is required of that the trustees that they -
- 10.4.1. exercise their discretion for the purpose for which it was conferred on them and not for any ulterior purpose;<sup>12</sup>
  - 10.4.2. take into account all relevant facts and circumstances (such as the financial history of the fund) and disregard irrelevant facts and circumstances;<sup>13</sup>
  - 10.4.3. act with impartiality<sup>14</sup>; and
  - 10.4.4. make a decision that is reasonable in that it is rationally connected to the object sought to be achieved and impairs the rights and expectations of

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longer in service. They certainly had a duty to exercise their discretionary power honestly and for the purpose for which the power was given and no so as to accomplish any ulterior purposes. But they were the judges of whether or not their exercise of the power was fair as between the benefited beneficiaries and the other beneficiaries. Their exercise of the discretionary power cannot be set aside simply because a judge, whether the Pensions Ombudsman or any other species of judge, thinks it was not fair." [at page 569].

See also the *dicta* of the UK Court of Appeal in *Edge & others v Pensions Ombudsman & others* [1999] 4 *All ER* 546 (CA), the SA High Court in *Oskil Properties Limited v The Chairman of the Rand Control Board & others* 1985 2 SA 234 at 237 and the pension funds adjudicator in *Whitelock-Jones v Old Mutual Staff Retirement Fund* [2000] 6 *BPLR* 674 (PFA).

<sup>12</sup> *Pharmaceutical Manufacturers Association of South Africa v President of the Republic of South Africa & others* 2000 (3) *BCLR* 241 (CC).

<sup>13</sup> See the judgment of the pension funds adjudicator in *Jenkinson v Nedcor Pension Fund* [2001] 9 *BPLR* 2467 (PFA) in which the adjudicator stated at paragraphs 19 – 21:9 (C)

"The fund states that since the recipients of the enhancement had to be restricted in some way, the trustees decided that it was fair and reasonable to limit it to those former members who were still part of the Nedcor family. This took into account the interest of the Employer who would benefit from a motivated and contented workforce. It also took into account the fact that existing members of the Nedcor Defined Contribution Funds now bore investment risk. I am satisfied that this constituted a rational basis to determine which category of former members of the fund should be paid the enhancement and thereby share in the surplus. The test is not one of fairness but of proportionality. The concept of proportionality in administrative law expresses the idea that the extent to which the action of the public authority may infringe individual rights should not go beyond the degree necessary for serving the public interest. Put differently, the administrative act must be proportionate to the advantages of the act to the public."

<sup>14</sup> [1999] 4 *ALL ER* 546. In *Edge and others vs Pension Ombudsman and others* the English Court of Appeal concluded that:

"The so-called duty to act impartially – on which the ombudsman places such reliance – is no more than the ordinary duty which the law imposes on a person who is entrusted to the exercise of a discretionary power: that he exercises the power for the purpose for which it is given, giving proper consideration to the matters which are relevant and excluding from consideration matters which are irrelevant. If pension fund trustees do that, they cannot be criticised if they reach a decision which appears to prefer the claims of one interest – whether that of the Employer, current employees or pensioners – over others. The preference will be the result of a proper exercise of the discretionary power." (My emphases)

those affected by the decision to the least extent possible in the circumstances.<sup>15</sup>

11. The Registrar is not, with respect, empowered to reject surplus apportionment schemes simply because they do not accord with what he would regard as equitable in the circumstances. He can only do so to prevent manifest injustice.

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<sup>15</sup> In an unpublished speech made to by pension funds adjudicator to the members of the Pension Lawyers Association shortly after he was appointed the first pension funds adjudicator in January 1998, Professor Murphy said that the purpose of an enquiry into the reasonableness of a trustee decision is to assess the soundness of the decision-making process. He said –

“Procedural grounds focus on the process of decision-making and the participation of the affected parties; for example, was there a fair hearing or were relevant considerations properly taken into account? Substantive review involves challenges on the ground that the decision is outside the letter or purpose of the conferred power or on the ground that the decision is unreasonable.”

Relying on how van Deventer J in his judgment in *Roman v Williams NO 1998 (1) SA 279 (C)* described the “constitutional test of justifiability” in relation to the reasons given for the decision”, the adjudicator said –

“Trustee decisions, to be reasonable, first must be motivated by the pursuance of a socially legitimate objective. Secondly, the means of giving effect to the decision should be proportional in the sense of being carefully designed to achieve that objective and should be rationally connected to it. Additionally, the means should impair the rights and legitimate expectations of affected parties as little as possible.”

Although this determination was issued before the enactment of the Pension Funds Second Amendment Act 39 of 2001, it is arguable that it reflects principles applicable to the application of the provisions incorporated in the Act in terms of that statute.

