

SYNOPSIS

LEGAL ISSUES ARISING FROM DOCTORAL RESEARCH ON SOUTH AFRICAN PENSION FUND CONVERSIONS: 1980 – 2006

1. RESEARCH ABSTRACT

Between 1980 and 2006, thousands of South African pension funds converted members from defined benefit to defined contribution structures. This research set out to answer the questions of why this phenomenon occurred and whether peculiar environmental circumstances influenced the outcome.

The research framework identified various stakeholders in the retirement fund industry – government, regulator, pension funds adjudicator, ombudsman for long term insurance, trade unions, members, trustees, business, employers and service providers – and isolated the elements to be considered in the research.

Industry experts were interviewed to obtain a macro view of the phenomenon and specific manifestations of the phenomenon were also case studied. The purpose of the research was to develop a model for managers to assist them in dealing with fundamental environmental change.

Qualitative research methodology was utilised and feedback from semi-structured interviews was categorised into several emergent themes. Within-case and cross-case analyses were conducted on the sub-cases.

Research results indicate that the conversion phenomenon occurred in two waves – one initiated in the 1980's and driven by the trade unions and a second in the 1990's driven by employers, often at the advice of their consultants. Evidence of the start of a third wave also emerged.

Results indicate that an ¹environmental shock exerted a substantial influence on the course of events and that the phenomenon occurred in an environment of fundamental political, economic and social change. Under these environmental shock circumstances:

- Various factors combined to drive organisational evolution (i.e. adaptation to the environment);
- Adaptation speed was inappropriate and exceeded that required for sufficient thought;
- Uncertainty and ²vacuum circumstances arose leading to consequences that require redress;
- The power of the relative stakeholders changed and influenced the strategic outcome;
- Ethical factors became ³consequential; and
- Organisations acted to reduce uncertainty.

Existing literature explained organisational behaviour in environments of competitive shock and high turbulence, but not in circumstances of environmental shock. A model emerged from the research to assist managers in dealing with fundamental environmental change and contributes to economic theory by explaining organisational behaviour under conditions of environmental shock.

The emerging model was tested on the phenomenon of pension fund reform and can also be applied to Broad-Based Black Economic Empowerment (B-B BEE).

¹ An environmental shock can be defined as “a condition that arises where business or societal rules are inadequate, or do not exist, to deal with unfolding events” (George, 2006).

² There was no precedent and existing rules were inadequate.

³ Consequentialism suggests that the morality of an action can be judged solely on its consequences.

Results indicate that the emerging model is robust and can serve as a useful analytical tool under conditions of environmental shock.

2. SUMMARY OF RESEARCH RESULTS

55 interviews were conducted to obtain a macro level view of the conversion phenomenon and eight cases were studied to consider specific manifestations of the phenomenon. Key findings are listed below:

2.1 Environmental change

2.1.1 Political factors

- Union proxy for government in exile
- Political struggle waged on the shop floor

2.1.2 Economic factors

- Globalisation
- Rising cost of defined benefits

2.1.3 Social factors

- HIV/Aids
- Rural pensioners
- Withdrawal benefits

2.1.4 Legislation

- Amendments to the Pension Funds Act

2.2 Evolutionary driving forces

- Trade unions seeking political power
- Employers seeking certainty
- Consultants seeking profit and new markets

- Strike activity disrupting productivity
- Poor benefits questioning suitability of defined benefits
- Social change with HIV/Aids and employment relationships
- Distrust of member elected trustees
- Struggle for control over fund assets
- Potentially rising costs and investment risk
- Market strength
- Valuation bases inflating surplus available to employer

2.3 Pace of change and uncertainty

- Too fast
- Not thought through
- Gathered momentum
- Out of control - frenzy
- Employers felt pressing need
- Complexity
- Not evaluated
- No legislative framework
- No actuarial guidelines
- No strategy
- No collective thought
- Steep learning curves

2.4 Consequences

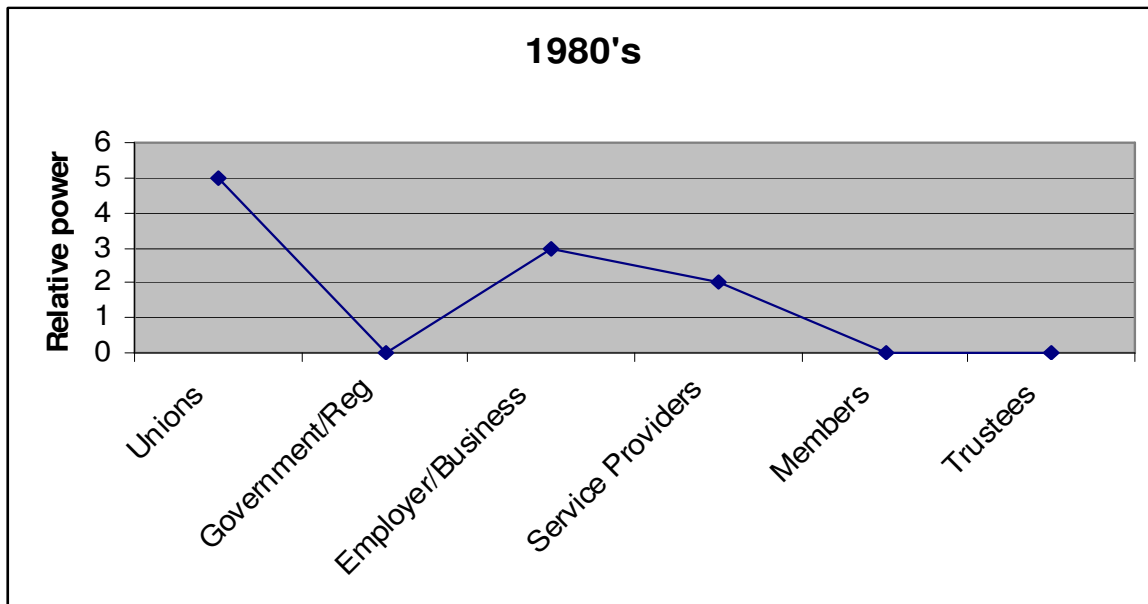
- Leakage – on retirement and death
- Service provider dominance – took over from the employer
- Surplus could not be accessed, abused by employers
- Social benefit eroded – employer no longer underwrites risk
- Education requirements substantially increased
- Risk passed to ill-equipped members
- Unclaimed benefits rising

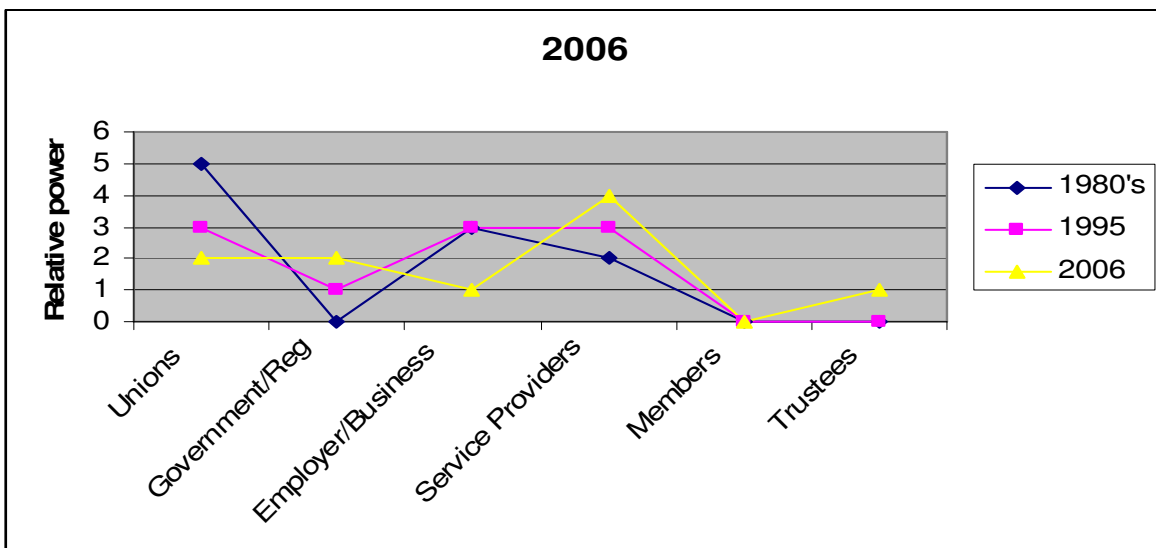
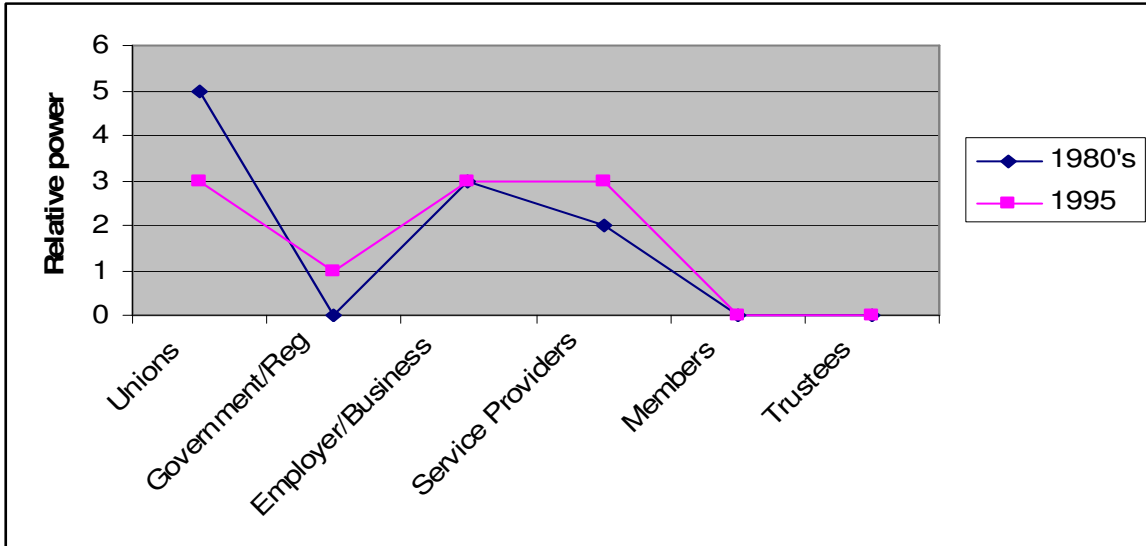
- Intergenerational cross-subsidisation lost

2.5 Redress

- Pension Funds Second Amendment Act
- Pension fund reform
- Trustee education
- Member education
- Adjudicator rulings

2.6 Relative stakeholder power



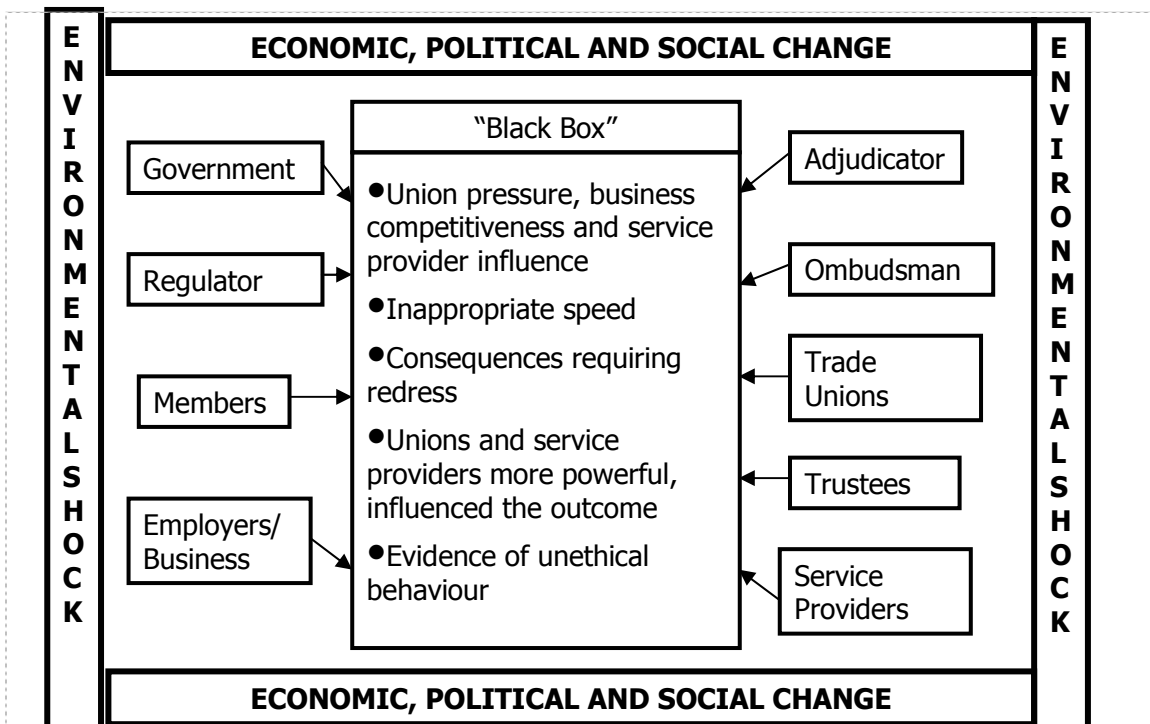


2.7 Ethics

- Members worse off and needed protection
- Poor transfer benefits
- Investment reserve not distributed
- Surplus valuation manipulated
- Some deliberate unethical behaviour
- Policy change is socially desirable if:
 - Everyone is better off (weak pareto criterion)

- At least some are made better off while no one is made worse off (strong pareto criterion)
- After pension fund conversions some members are worse off
- Conversions fail both the strong and weak criteria for social desirability

2.8 Emerging propositions and model



- There was an environmental shock: political, economic and social change – unions, employers and consultants responded
- Evolution was driven by political factors (union desire for political power – “first wave”) and economic factors (business competitiveness – “second wave”); signs of a “third wave”
- Inappropriate speed (insufficient for effective thought processes)
- There was uncertainty, no precedent to follow and several consequences arose that are being addressed

- The relative power of stakeholders changed and is reflected in the strategic outcome – service providers, unions, regulators and the rise of consumerism
- Some unethical behaviour occurred

3. IMPLICATIONS FOR PENSION LAWYERS AND LEGAL ISSUES

Several implications for pension lawyers emerged during the course of the research.

- Some now wondering: “what happened?”
- Research has revealed some interesting patterns
- Pension funds are a microcosm of South African society and are indicators of broader influences
- There remains much conflict and vested interest
- The pension fund evolution is on-going
- Pension funds were successful tools for political liberation
- By taking control over pension fund assets, union members provided the capital that kick-started Black Economic Empowerment
- Pension funds are being mobilised for economic liberation
- Environment poised to take another evolutionary leap

3.1 Legal issues

Some legal issues arising from the research will be explored during the session:

- Regulatory framework
- Surplus
- Corporate governance
- Fiduciary responsibilities of Boards
- Third conversion wave

- Legal training
- Pension Fund Reform
- B-B BEE Codes of Good Practice
- South African legal environment

4. EVOLUTIONARY SURVIVAL TIPS FOR PENSION LAWYERS

The industry is evolving and the outcome is unknown.

Will it be Justice for all, Jaws or Jurassic Park?

A model emerging from the research was applied to pension fund reform and it points to the following evolutionary survival tips for pension lawyers:

- ✓ Recognise that the environment is in shock - existing rules are inadequate
- ✓ Understand the various factors that are combining to drive adaptation to the environment
- ✓ Note the speed of change – is it appropriate?
- ✓ Consider what is uncertain and where precedent is absent
- ✓ Explore the potential consequences of proposed change
- ✓ Assess the relative power of the stakeholders including your own
- ✓ Develop a code of conduct