BEYOND THE RUBICON –
RETIREMENT FUND TRANSFERS IN THE MINIMUM BENEFITS ERA

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ADDRESS TO THE CONFERENCE OF THE PENSION LAWYERS ASSOCIATION, CAPE TOWN, FEBRUARY 2004

1. INTRODUCTION

1.1 When the dust finally settles on the last surplus apportionment scheme, South African retirement fund members and advisers will find themselves in the era of minimum benefits. Section 14(c) of the Pension Funds Act will require that transfers of the business of a retirement fund must accord recognition to the minimum benefits specified in the new sections 14A and 14B.

1.2 In the past, such transfers had no statutory underpin, and gave rise to a number of disputes. The so-called 'R80 billion surplus' in South African retirement funds supposedly originated from fund transfers, and was one of the main drivers behind the Pension Funds Second Amendment Act of 2001 ('the Surplus Act') which gave birth to the new era.

1.3 So, are transfer disputes a thing of the past? Will names like 'Tek' and 'Pepkor' retreat into the musty recesses of the law library? Will (to use the motto of the 2003 Pension Lawyers' conference) another link in the lawyer's feeding chain be broken?

1.4 In Section 2, I briefly sketch why the pricing of transfer values was more of an art than a science in days gone by. Section 3 presents some of the disputes that went to Court or Adjudication. Against this background, section 4 considers the requirements of the new era, and Section 5 concludes that there is life in the old dog [chain] yet!

1.5 The greater portion of this talk concerns defined benefit funds, currently a dying breed in South Africa. However, there are still quite a number of these funds in existence – including some of our largest funds – and they will continue to need professional advice. There are nevertheless important issues for defined contribution funds as well.

1.6 A more in-depth analysis of these issues may be found in my paper "Pricing Transfer Values" which has been submitted to the SA Actuarial Journal for

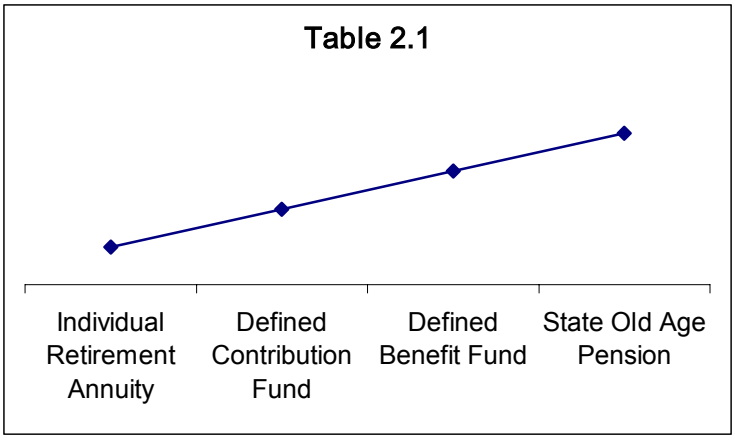
publication. In the meantime, the paper is available on the website of the Actuarial Society of South Africa (www.assa.org.za)

2. WHY DO ACTUARIES MAKE TRANSFER VALUES SO COMPLEX?

2.1 Actuaries (and lawyers) are often accused of making a meal of transfer values. Sometimes it is allegedly because they are illiterate in anything but actuary-speak, sometimes its because of the need to generate more of their stupendous fees, and sometimes its in order to protect and enrich the employer with whom they are hand-in-glove. My reaction is that transfer values are complex because retirement funding is complex, irrespective of the involvement of the professionals.

2.2 Writing in the British Actuarial Journal of 1999, Mark Stocker claims that the nature of retirement provision within a country reflects the culture of the country, and changes naturally as the underlying cultural values and imperatives change. Referring to the United Kingdom, he notes that the 1960's and early 1970's were characterized by the cultural values of loyalty and collectivism. This tendency was reflected by defined benefit pension funds, which mainly rewarded long-serving employees by awarding a pension that was calculated as a fraction of the employee's lifetime earnings.

2.3 From the late 1970's, the cultural values of individualism became dominant, and accordingly, solidarity and paternalism started to disappear from pension fund designs. Two of the key elements of a pension funding arrangement are contributions and benefits. In some arrangements, a member's benefits are strongly related to his/her contributions. Using a biblical simile, 'solidarity' could be defined as the extent to which benefits are not related to 'each according to their means [contributions]' but rather to 'each according to their needs'. A simplified ranking of some common South African pension arrangements in terms of solidarity is shown in Table 2.1.



2.4 Where members share no risks with each other, it is usually simple to earmark such members' past contributions to the fund, plus debits and credits, as equal to their liabilities. There is thus a "match" between assets (contributions) and liabilities (benefits). As more and more risk sharing is introduced, there is a mismatch between the assets contributed by (and on behalf of) the individual and the liabilities undertaken by the Fund in respect of that individual – as seen in the extreme example

of a State Old Age Pension where taxpayers contribute but only eligible citizens may benefit.

2.5 The word 'transfer' is sometimes used to refer to a benefit specified in the rules of a fund. For example a defined benefit payable on resignation may be transferred to another pension fund. In this address, however, I am discussing the transfer of a member's interest in one fund to another fund – a *quid-pro-quo* for a member who gives up the right to various benefits in the fund. The quantification of such interest is problematical where there is an element of solidarity in the fund; and even more so when the rules are silent. This state of affairs is the challenge that actuaries are uniquely placed to resolve using actuarial techniques and judgement.

2.6 Transfers of pensions business in South Africa are regulated by Section 14 of the Pension Funds Act ('the Act'). The Registrar of Pension Funds has to be satisfied that a proposed transfer is reasonable and equitable and accords full recognition to the rights and reasonable benefit expectations of the persons concerned in terms of the rules of a fund and established practice. The Registrar must also be satisfied that the proposed transfer will not endanger the financial soundness of any fund.

2.7 Michael Berg, writing in 'The Actuary' magazine of 2001 compared what he considered common transfer methodologies at the time in the UK and South Africa. The UK approach was to calculate the present value of accrued benefits, with no allowance for future salary increases, but limited allowance for pensions increases. A Market Value Adjustment was then applied to allow for the fact that interest rates in the market were different from those used in the accrued benefits calculation. By comparison, the South African approach was to calculate the actuarial reserve used for long-term funding purposes, which allowed for future salary increases. Market Value Adjustments (or a share of Investment Reserves) were not usually incorporated. Interestingly, Berg made sample calculations which showed that the two methods produced fairly similar results, with South Africa paying slightly more for younger transferees, and the UK benefiting the older ones.

2.8 Addressing the 1997 conference of the Actuarial Society of South Africa ('ASSA'), Tony Kamionsky voiced the growing concerns of a number of actuaries. He noted how employers, trustees, actuaries and consultants were required to effect transfers from defined benefit to defined contribution schemes in an environment with very little explicit legislation, virtually no legal precedent, no actuarial guidance notes and no controls over who may advise on conversions. They made the point that actuarial reserves, while appropriate in a funding situation, are not necessarily appropriate in a transfer situation.

2.9 In February 2001 during the discussions on the proposed Surplus Act, ASSA asked its Retirement Funds Surplus Committee to report on whether there was any justification for the actuarial profession to support and/or promote measures that may be regarded by some as interference in the affairs of employers. The Committee's view was that the implementation of minimum bases and standards of practice was justified on the following grounds:

(1) Although the provision of retirement benefits is voluntary, membership of a retirement fund, where it exists, is compulsory for eligible employees in terms of

existing income tax legislation. An employee who is unhappy with the employer's retirement funding arrangement is therefore at a disadvantage, which increases the onus on those concerned with the management of the fund (including the actuary) to protect the interests of the members.

(2) There has been a steadily increasing flow of complaints, allegations and media reports over the past few years involving dissatisfaction with transfer and other termination benefits. It is evident that the absence of a measure of consistency in the actuarial determination of such values has led to some confusion in the eyes of the public with regard to the role of the actuary. Differences in values that may be explained and justified in actuarial terms are seldom understood and appreciated by the general public.

(3) Despite a significant trend towards improving the benefits of early leavers, many funds still provide inadequate withdrawal benefits. This tends to reinforce a view that seems to be held by many people, namely that retirement funds represent poor value for money and that actuaries should partly carry the blame.

(4) The profession has recently placed much more emphasis on the need for actuaries to have regard to, and better serve, "the public interest". This concept, which is closely related to that of "reasonable benefit expectations", calls for a rethink of past practices.

The Committee suggested that, in future, a member who has moved between retirement funds during his or her career and has preserved the amounts available on each change of employment, should have a reasonable expectation of receiving an acceptable pension on retirement.

2.10 At the same time, there were developments in actuarial techniques using insights from financial economics, in which market values are generally used for decision making. This seems to have been one of those cultural trends as envisaged by Mark Stocker, encouraged perhaps by new accounting standards. Traditional actuarial funding methods do not *price* liabilities. A single, discounted, 'value of future liabilities' is merely a convenient shorthand to show the funding level. Funding levels can also be shown through cash flow projections, and other methods. This is not to say that traditional funding methods are inappropriate for the right purpose. However, any putative 'price' extracted from a traditional funding method is incidental to its main objective.

3. ACTUARIES DO IT WITH DISCRETION

3.1 I hope I have now convinced you that actuarial discretion needs to be exercised when recommending a price for members transferring out of a retirement fund – at least in the era before minimum benefits. The exercise of this discretion is 'policed' by the professional standards and guidelines of ASSA. Courts find it difficult to intervene – in the words of John Murphy, former Pension Funds Adjudicator:

> Judges naturally hesitate to perform the tasks of a brain surgeon. Actuaries are entitled to similar deference. Accordingly, the test for judicial intervention must be constrained to testing the reasonableness and rationality of actuarial methods.

Nevertheless, cases have been heard concerning the exercise of this discretion, and – if you will indulge the temerity of a mere actuary to address such a learned legal audience on the finer points of the law – some of these are briefly analysed in this section[1].

3.2 KRANSDORFF VS SENTRACHEM[2] ('Sentrachem')

3.2.1 In Sentrachem, the applicant contended that his withdrawal benefit was neither fair, nor in terms of the rules of the pension fund, nor in terms of his contract of employment. The Pension Funds Adjudicator determined that the benefit was in terms of the rules, that fairness was not a requirement for a defined benefit (as opposed to a transfer in terms of S14 of the Pension Funds Act), and that labour issues were beyond his jurisdiction.

3.2.2 Nevertheless, because the operative withdrawal rule defined the benefit as the greater of reserve value or twice accumulated contributions, the Adjudicator addressed himself to the computation of reserve values. He quoted with approval from Richard Nobles' 1993 UK work "Pensions, Employment and the Law":

> The peculiar expertise of the actuary is the ability, using assumptions and methods to make decisions about the future: in the context of pension schemes, to determine what level of assets will be required to pay for a given level of pensions. But the question which remains is whether actuarial judgements are made according to strict criteria, so that the involvement of this profession enhances the protection offered by trust law. Or are actuarial judgements so flexible that the involvement of the actuary may operate so as to disguise what is, in effect, managerial control of pension scheme funding?

3.2.3 However, the Adjudicator declined to enter substantively into the fray with brain surgeons and actuaries. Rather, he concluded that limitations on actuarial discretion, where appropriate, could reduce the potential for disputes. Thus he stated:

> Actuaries traditionally have had significant influence on the content of pension fund rules. Those rules, as stated, routinely grant actuaries wide discretions. It is, therefore, incumbent on the actuaries to ensure that discretions are circumscribed by appropriate decisional referents, as required by the Constitution, and that such discretions are exercised reasonably and fairly in accordance with such decisional referents.

3.2.4 ASSA responded to this challenge by issuing Guidance Note 204 "Actuarial Discretion in Terms of Retirement Fund Rules" in August 1999. This brief guidance note states that it is best practice for actuaries to bring instances of discretion to the attention of trustees, and to suggest appropriate referents for their approval.

3.3 THE ASSOCIATED INSTITUTIONS PENSION FUND ('AIPF') VS LE ROUX[3] ('UNISA')

3.3.1 In UNISA, the Supreme Court of Appeal overturned the decision of the court *a quo* in a matter concerning actuarial discretion. UNISA employees who had

[1] Information regarding these cases has all come from documents in the public domain
[2] Kransdorff v Sentrachem [1999] 9 BPLR 55 (PFA)
[3] AIPF vs Le Roux [2001] 8 BPLR (A)

previously accepted an offer to transfer out of the AIPF subsequently challenged the methodology used by the actuary in determining their transfer values.

3.3.2 At the previous valuation, approximately three years before, the actuary was concerned about the state of the data, and had accordingly created a reserve. For various reasons, the transfer calculations were performed before the results of a new valuation, including an audit of the data, were known. Had the updated data been used, the data reserve would have been less necessary – and therefore the transfer values would have been higher. The court *a quo* decided that the phrase 'calculated by the actuary' meant that the transfer value had to be determined on reliable data, and that just because the calculation had to be made by an actuary, this did not mean that the actuary was free to decide when, what and how. The actuary's determination was struck down, and he was requested to redo it with accurate data.

3.3.3 However, on appeal, Cameron J.A. was of the opinion that linguistic analysis of the regulation showed that the actuary had to perform an actuarial function, i.e. the attributes of professionalism and skill peculiar to that field of expertise. The uncontested evidence of the actuary should be accepted – that the transfer could not be performed with mathematical precision, bereft of assumptions, allowances or margins in regard to uncertain facts and figures. Thus, the actuary's original determination of the transfer values was reinstated.

3.3.4 Nevertheless, Cameron J.A. did state that, in terms of the (interim) Constitution, an actuary's determination had to be lawful and procedurally fair as well as justifiable in relation to the reasons he or she gave for it.

3.4 VAN ZYL VS AIPF[4] ('UP')

3.4.1 In this matter, employees of the University of Pretoria launched a similar challenge to that of their contemporaries at UNISA. This time, actuarial experts were called on by both sides to debate whether the transfer values could pass the test imposed by Cameron J.A.'s abovementioned constitutional dictum. Arguments were led for and against the need to distribute a share of the reserves to transferring members, and whether the reserves were justifiable in terms of the reasons given. Also, in the absence of a report to members by the actuary or the fund on the transfer methodology, arguments were made regarding the steps that the members should have taken to double-check the actuary's calculations. The Court did not definitively decide this issue, except to state that the transferring members could reasonably expect the actuary to do a professional job, and thus had no duty to check their transfer values.

3.4.2 Arguments were also put forward regarding the calculation of the funding percentage. For various reasons, the funding percentage had been calculated at a point in time, and then updated over a period of fifteen months to reflect changes in the market value of the original assets. It was alleged that this method ignored various interim developments such as the fact that contributions had been increased in order to improve the funding percentage. In his judgment, Botha J. expressed the view that the term 'market value' in the regulations connoted the actual value and not a notional value established by projections. He stated:

[4] Van Zyl vs AIPF unreported case 18773/99 (T)

> It was argued that the phrase "as determined by the actuary" refers to the determination of the market value. I cannot agree. In my view it refers to the "calculated aggregate actuarial obligation of the fund". It tells one who is to calculate the aggregate actuarial obligation of the fund, namely the actuary appointed in terms of the regulations. I cannot see any licence in this phrase to the actuary to determine asset values that are not market values.

3.4.3 Botha J. accordingly came to the conclusion that to determine the funding level with reference to notional values of assets was *ultra vires* the regulations. The transfer values were set aside and must be recalculated. However, the matter has subsequently been taken on appeal.

3.5 ADRIAENS VS LANGEBERG FOODS PENSION FUND[5] ('Langeberg')

3.5.1 In Langeberg, a group of pensioners contended that a scheme involving the transfer of their pensions to an insurer was unreasonable and inequitable. Based on the results of an interim valuation pensioners and members of a defined benefit fund were asked to decide on an offer to outsource their pensions / transfer to defined contribution respectively. Most of the pensioners accepted the offer, even though active members were to receive a greater nominal increase in benefit than pensioners, and a substantial portion of the surplus was to be retained in the rump of the defined benefit fund.

3.5.2 On enquiry, some of the pensioners were informed of the estimated allocation of the surplus between pensioners, active members and the fund. In fact, the amount of surplus retained in the fund turned out to be several times larger than the estimates, mainly because of good investment performance during the nine-months since the interim valuation; the non-disclosure of an investment reserve; and a profit arising from outsourcing the pensions at a price less than the reserves held for pensioners in the fund.

3.5.3 The pensioners first raised their objections with the Registrar of Pension Funds. In response to an enquiry from the Registrar, the actuary stated that the surplus position of the funds was, in the opinion of the trustees, not relevant to the choice that the pensioners had to exercise. The surplus information was therefore not generally made available, but was given to those who asked. The Registrar then confirmed his decision to grant a Section 14 certificate.

3.5.4 In his determination, the Adjudicator noted that, before issuing such certificate, the Registrar had to investigate the legality, reasonableness, equity, financial soundness and actuarial prudence of any scheme. The Adjudicator quoted from Lord Justice Staughton in a UK case, Stannard v Fisons Pensions Trust, as follows:

> It therefore seems to me that … there was some degree of likelihood that the Fisons fund would continue to be in surplus for the foreseeable future; and there was some degree of likelihood that the existing employees and pensioners would receive some benefit from the surplus in the future, in the form of increased pensions or other benefits. When the trustees

[5] Adriaens vs Langeberg Foods Pension Fund [2000] 1 BPLR (PFA)

> came to consider what was just and equitable upon a division of the fund … they ought to have borne those points in mind and made some evaluation of them.

3.5.5 The Adjudicator believed that surplus information is highly relevant, and pensioners granted an option to transfer their investment from one vehicle to another have a clear right to be furnished with adequate appropriate information to enable them to make an informed choice about which vehicle to invest in. He continues:

> Accurate information about the current financial position of the fund is a prerequisite to a proper choice. … It may indeed not be [the actuary's] duty to predict the residual surplus, but it was his duty to ensure that the transfer of business was reasonable and equitable and as such based on reliable current information. Accepting that the scheme invariably will be required to be worked out in advance, it does not follow that the trustees and the fund actuaries can simply take outdated historical information into account and ignore developments and the financial situation at the actual date of transfer. If circumstances change which significantly impact upon the investment of the fund between the time when the section 14 scheme was devised and the effective date of transfer, there is to my mind some duty to make an appropriate adjustment.

3.5.6 The Adjudicator therefore declared the Section 14 scheme to be unreasonable, inequitable and an improper exercise of the power of the trustees.

3.6 DE WET VS FSB AND THE REGISTRAR OF PENSION FUNDS[6] ('PEPKOR')

3.6.1 In Pepkor, the Supreme Court of Appeal upheld the decision of the court *a quo* to allow the Registrar to rescind a Section 14 certificate. It was alleged that information provided in the Section 14 documentation regarding the size and allocation of the surplus was incorrect. *Inter alia,* this was alleged to imply that members who transferred did so without knowledge of a substantial surplus.

3.6.2 Regarding the question of informed consent, Rogers A.J. stated in the court *a quo:*

> It might be highly desirable that members should be fully informed of such matters, but the fact of the matter is that this is not amongst the requirements listed in Section 14, nor, in my view, is it implicit … It appears that the legislature was content to appoint the Registrar as the protector and guarantor of [members'] interests.

He nevertheless noted that adequate information was a requirement in terms of the Registrar's PF Circular 78.

3.6.3 Regarding the alleged exclusion of certain assets from the surplus calculation provided to the Registrar in terms of PF Circular 78, Rogers A.J. stated, in similar vein to the UP matter:

> I can see no basis on which the exclusion of any of the three special surpluses could be defended. Their exclusion strikes me as entirely arbitrary.

[6] Pepkor Retirement Fund vs FSB unreported case 198/2002 (SCA)

3.6.4 In similar vein to the Stannard matter referred to above, Cloete J.A. remarked in the judgement on appeal:

> It is true that [the members] were not legally entitled to participate in the surplus, but they had not only the hope that the trustees might use the surplus to pay increased benefits but also the peace of mind in knowing that their benefits would be more than adequately protected.

3.6.5 And in similar vein to the UNISA matter, Cloete J.A. referred to Section 33 of the Constitution in terms of which everyone has the right to administrative action that is lawful, reasonable and procedurally fair.

3.7 TEK CORPORATION PROVIDENT FUND VS LORENTZ[7] ('Tek')

3.7.1 No review of recent pension fund litigation would be complete without a mention of Tek, which decided the age old question of 'who owns the surplus?'. In 1994, in the Lintas matter, the FSB Appeal Board found it acceptable that surplus could be paid to an employer on liquidation. The Registrar initially followed this guidance, but after taking legal advice, subsequently refused to register any such rule. The FSB appeal board confirmed its opinion in 1999 in the Paarl Widows matter, after the initial hearing of Tek.

3.7.2 In his appeal judgment, Marais J.A. declared that the surplus belongs to the fund. It followed that all stakeholders needed to negotiate the allocation thereof. In passing, he also referred to the difficulties that actuarial science has in being exact, since:

> Some of the data available may be relatively immutable and provide a secure foundation … much is not.

4. THE MINIMUM BENEFITS ERA

4.1 The Surplus Act came into effect from 7th December 2001. It amended the old section 14 (c) to require that transfers must accord recognition to the minimum benefits i.e. a member who ceases to be a member of the fund prior to retirement in circumstances other than liquidation of the fund shall be paid not less than the minimum individual reserve ('MIR'). Only on liquidation, or an internal reorganisation from defined benefit to defined contribution, may such reserve be reduced to reflect any deficit in the fund.

4.2 The MIR in a defined contribution fund is basically the member's account. In a defined benefit fund, the MIR is basically the 'market value' of the member's accrued deferred pension, subject to a minimum based on contributions. In both types of fund, the trustees must also apply their minds as to whether a proportionate share of (post-Surplus Apportionment Date) surplus and contingency accounts should be included. This is in terms of sections 15C and G of the Surplus Act.

4.3 The Registrar duly prescribed that, in calculating the MIR for a defined benefit fund, the capitalisation of the pension at date of retirement should normally use the

[7] Tek Corporation Provident Fund & Others vs Lorentz 1999 (4) SA 884 (SCA)

same assumptions as those used by the actuary in the preceding statutory actuarial valuation. For the period before retirement, a market related discount rate was prescribed, and it was stated that no allowance should be made for the chance of death or resignation before retirement.

4.4 In 2001, ASSA appointed a Retirement Fund Surplus Committee to inquire into the bases for calculation of transfers, conversions, and related issues, and to establish appropriate minimum bases and standards for practical application. It was noted that transferring the MIR may well be insufficient to ensure that the reasonable benefit expectations of members will be met. For example, in the event of a compulsory transfer from a defined benefit scheme to a defined contribution scheme, there is an argument for making up the loss of the future cross-subsidy the member would have enjoyed in the defined benefit scheme as he or she got older. However, it was felt that this was an obligation of the employer rather than the fund, and therefore the employee could be compensated in other ways. The actuary nevertheless had an obligation to ensure that the employer and the employees fully understood the loss of the future cross-subsidies caused by the transfer.

4.5 The Registrar is currently negotiating with Business and Labour regarding which, if any, contingency reserves could generally be held back from distribution to stakeholders in a surplus apportionment scheme. One might expect that Business would be recommending that this is a matter to be left to the discretion of the actuary, whereas Labour might be in favour of only necessary and specific reserves, relying on the employer's duty to fund any other deficit in terms of section 30(3) of the Act. It remains to be seen whether any of this will fetter the discretion of the trustees (section 15G) when transfers occur *after* the surplus apportionment date.

5. BEYOND THE RUBICON : PRICING OF RETIREMENT FUND TRANSFERS IN THE FUTURE

5.1 Is it now clear that funding methods are not pricing methods (although it is possible that the same methodology might serve for both in some circumstances)? A *pricing* basis has been incorporated into the pre-retirement portion of MIR's by the Registrar. This will probably differ from the funding basis used at the previous statutory valuation basis, even allowing for the fact that the statutory basis will have taken minimum benefits into account.

5.2 For the post-retirement portion of MIR's the Registrar uses the previous statutory valuation basis as the default method and thereby reintroduces actuarial discretion. Furthermore, the use of the previous statutory valuation basis is not mandatory, and the actuary may motivate for a different basis to be accepted. Such motivations should surely be the rule rather than the exception since actuarial guidance note 201 clearly indicates that valuations for transfer purposes are different from statutory valuations, and requires the actuary to carefully examine the method and assumptions to make sure they are appropriate.

5.3 It must be remembered that MIR's are exactly that – a statutory underpin, *not* a prescribed value. The actuary and trustees are free to use another basis, as long as the minimum is exceeded. In fact, PF Circular 78, which sets out the Registrar's requirements for approval of a Section 14 transfer, requires motivation if a basis other

than that of the previous statutory basis is used. In both the Pepkor and UP matters, a former Registrar testified along the lines that this was necessary to prevent abuse.

5.4 It appears that bulk Section 14 transfers will be problematical if a fund is in deficit, unless the transfer values are well in excess of MIR. This is because the Section 14 procedures allow for a reduction because of a deficit in the fund, but the MIR procedures do not! Trustees may have to seek a partial liquidation in these circumstances, and thereby shift the liability for the shortfall to the employer in terms of section 30(3) of the Surplus Act.

5.5 Section 15G of the Surplus Act envisages transferees sharing in reserves. Actuaries need to consider carefully how any estimate of the reserve at date of transfer will be calculated. An FSB official gave his opinion, at a recent workshop on the Surplus Act, that an annual calculation of Investment Reserve as a percentage of liabilities would suffice. This seems inappropriate in a market value environment. If an estimate can be successfully challenged, the transferring members are given a one-way option against the fund.

5.6 To answer the question of whether to distribute a share of reserves to transferring members, the trustees will need to examine the purpose and technical construction of each reserve. For instance, Ant Lester has proposed a basis for solvency reserves, which is basically the difference between the fund's liabilities on a statutory basis and on a discontinuance basis at minimum benefits. It is clearly inappropriate to add this to a transfer value which has already been calculated on the minimum benefits basis. Similarly some investment reserves are suitable for distribution, others are not. There is a draft circular from the Registrar on the subject of contingency reserves, but this refers specifically to the distribution of surplus on the surplus apportionment date.

5.7 The acid test of a transfer method remains that transferees should have a reasonable expectation of receiving an acceptable pension on retirement. Addressing ASSA in 2000 on the subject of actuarial discretion, Jeremy Andrew cautioned that ten different actuaries should each be able to combine judgement with technique to arrive at something acceptably close to the same transfer value. In Sentrachem, it was held that actuarial discretion must be subject to the law although in UNISA it was allowed that an actuarial function cannot be performed with mathematical precision. However, in that same matter, it was decided that an actuarial determination must be justifiable in terms of the reasons given for such decision. In UP, the court overturned an actuarial determination on the grounds that it was not appropriate to estimate market values when the exact market values could have been obtained. In Langeberg, it was held that an actuarial determination must be based on reliable and up-to-date information. (Before I start a run on the bank, let me hasten to add that these cases represent the sensational minority of actuarial involvement with transfer values. The overwhelming majority of transfers have not led to disputes!)

5.8. In transfer situations, there will always be some unhappiness, and it is easy to accuse the actuary to be favouring the interests of the employer. On the other hand, the employer has legitimate interests and rights – usually including the right to cease contributing to the fund. I believe that the concept of 'freedom with disclosure' can be of some help – i.e. all stakeholders will be given the opportunity to know and

understand and object-to what the trustees have approved. For instance, trustees could set up a standard Section 14 transfer procedure which would be called upon whenever a transfer loomed. This would include the need for a so-called 'actuary's letter', detailing the nitty-gritty of the calculation. This letter would be used, *inter alia*, by the actuary of the transferee fund to confirm the accuracy of the transfer values received. 'Freedom with disclosure' is not without its defects – for example, is it appropriate where the buyer (retirement fund member) does not have the ability to shop elsewhere?

5.9 In Langeberg, the adjudicator believed that members were entitled to adequate information and transparency. However, in Pepkor, the judge pointed out that informed consent was not a requirement of Section 14 of the Act, and that the legislator had appointed the Registrar to look after members' interests. Pepkor also revealed how little attention the Registrar was able to give to this task over the years. The Registrar's draft new Section 14 transfer procedure encourages the Board of Trustees to inform members about a proposed transfer, and give them the opportunity to object. This surely cannot be done without a report from the actuary on the details and implications of the transfer.

5.10 The use of market value based pricing methods means that transfer values will be volatile. Members with identical service records but slightly different dates of exit may receive quite different benefits. In the words of Simon Head, writing in the British Actuarial Journal in 2000:

> The adoption of a market value for assets must mean a volatile value for any comparable calculations of liabilities. This leads to volatile funding levels and volatile contribution requirements. It would appear … that the holy grail of an objective methodology and smooth results is unattainable.

5.11 This leads to the wider subject of unfair discrimination, which is prohibited by the Constitution and subsidiary legislation. The Pension Funds Adjudicator has made *obiter* comments from time to time about the apparent unfairness of different transfer values for retirement fund members with identical service records, but different ages. However, a suitable test case has not yet been decided. Unfair discrimination in transfer values can also stem from unfair discrimination in pension fund design as a whole, and that is where this nettle will have to be grasped. After all, defined benefit pension funds were *designed* to be discriminatory!

5.12 In conclusion, the potential will still exist in the minimum benefits era for disputes to arise around retirement fund transfer values, even in respect of defined contribution funds. Section 14 transfers will still be calculated as before, taking into account reasonable benefit expectations and all the other requirements of the Act. There will merely be an extra leg to the process comparing the Section 14 value to the MIR value. Actuarial discretion will still have to be exercised, and you will be pleased to note that ASSA is currently very active in identifying and promoting professional standards in this area.