PLA Disability Seminar 2008

1. The payment of disability and ill-health benefits and the issues arising therefrom have been the subject of several rulings issued by various Tribunals, Ombudsmen and the Courts. At the outset, it would not be unfair to state that the jurisprudence surrounding the development of the law relating to disability benefits is not as well developed as other areas of pension law. There are a variety of reasons for this, but in my view, it may be largely attributed to many of the disability rulings by the various Courts and Tribunals having been classified as unreported decisions, due to medical information contained in the rulings. Nevertheless, there has been a recent trend of greater reporting of these types of judgments and hopefully this over time will lead to a clear jurisprudence developing on this very important area of law. Thus, I sincerely hope that today's seminar marks the beginning and not the end of discussion on this topic.

2. I have been asked to make some introductory comments about disability benefits in relation to retirement funds, whose rules

provide such benefits. Disability benefits can arise in the context of various products and is not necessarily limited to occupational pension or provident funds. For example, we have the disability social grant payable by the State, disability benefits payable by the Road Accident Fund, and benefits payable in terms of the Compensation for Occupational Injuries and Diseases Act (previously known as the Workmans' Compensation Act). The purpose of today's seminar is to examine disability law with reference to retirement funds and insurance companies.

3. In the context of retirement funds, a useful starting point would be the definition of pension fund organization as contained in section 1 of the Pension Funds Act. In terms of the current definition, even having regard to the recent amendments creating a beneficiary fund, the primary purpose of an occupational pension fund organization is essentially to provide retirement and death benefits. Thus, there is no specific mention of disability benefits. However, as pension funds have evolved over the years, whilst the provision of retirement and

death benefits have remained the primary purpose, many other benefits have emerged, which can be termed as the secondary purpose of a pension fund albeit not strictly falling within the ambit of the definition in the Act. For example, funds today provide supplementary benefits in the form of disability benefits, divorce benefits, maintenance benefits, early withdrawal benefits, housing loans etc.

4. In the case of occupational pension and provident funds, the disability benefit may either take the form of a lump sum (which is normally a multiple of the member's pensionable salary) or it may be in a form of an annuity or pension payment. The lump sum benefit normally also includes the member's "fund credit" or "share of fund". Where a lump sum disability benefit has been paid, it is normal that the member's service with the employer and the membership of the fund will terminate simultaneously. Most occupational funds enter into reinsurance agreements with registered insurers, in terms of which the insurer agrees to cover the disability benefit subject to the conditions outlined in the policy agreement. This will include the

"free cover limit", that is, the amount for which a member is not required to submit medicals to qualify for the cover. Alternatively, the employer may establish a self-standing scheme, with the sole purpose of providing disability benefits, in which instance, the disability benefits will fall outside the ambit of the retirement fund rules.

5. Disability benefits are generally payable due to the member suffering from a physical or mental infirmity which prevents him from performing his own or similar occupation or any other definition as contained in the fund rules or policy provisions. In this regard, recent case law shows that mental and psychiatric illnesses (such as severe depression) may also constitute a disability – in appropriate circumstances.

6. It is also possible for the member to receive a temporary disability income benefit, which is normally secured by a separate insurance policy outside the fund and this benefit is paid in the form of a monthly income, usually limited to not more than 75% of the member's salary prior to disablement

after the member has been disabled in accordance with the definition set out in the policy. This definition can vary considerably in degree and the severity of the disability required to claim, but generally relate to the member's inability to perform his own occupation or any suitable occupation due to sickness or injury. The benefit is paid either until the member is able to return to work or alternatively reaches a certain age, or other fixed period outlined in the policy. Provision can also be made for a member to receive a partial benefit after a period of two years, if his only able to return to work at a lower earning capacity than his salary prior to the disability event.

7. The Supreme Court of Appeal in the matter of *Miller* held that the test in law to be adopted by a tribunal reviewing a disability decision is whether the respondent was unreasonable in forming the opinion that the member was not disabled within the meaning of the relevant rule or policy. In order to address this question, regard must be had to the applicable rule or policy, the complainant's duties in terms of employment as well as the medical evidence that was considered by the respondent

in forming its opinion. Thus, the reviewing tribunal is called upon to consider whether or not the respondent's opinion was both honestly held and one which a reasonable person could arrive at on the evidence before him. Put differently, the fact that the reviewing tribunal would have decided the matter differently is not necessarily by itself sufficient to show that the respondent's opinion is one which cannot be reasonably held.

8. Where benefits are reinsured with an insurer, most fund rules will contain a rule to the effect that the fund will only pay a benefit in the event of the claim being admitted by the insurer or to the extent that the claim is accepted by the insurer. As appears from the various rulings of the Adjudicator, the effect of the above condition is problematic in the sense that when the member sues the particular fund on the merits of the claim, the fund has a valid defence, in terms of which it cannot pay the benefit on the basis that the rules only permit it to pay when the claim is admitted by the insurer. Moreover, when the member sues the insurer, the insurer raises the defence of privity of contact, in terms where of there is no contractual nexus

between the complainant and the insurer permitting the Adjudicator to consider the merits of the claim.

9. However, where the disability benefit is rejected by the insurer and the fund, this is not necessarily the end of the matter as the fund rules may grant a special discretion to a functionary within the fund to determine whether the member whose disability application has been declined, should nevertheless receive a benefit payable by the fund (presumably from monies held in a reserve account). As for the exercise of any discretion in law, the existence of such a discretion does not mean that the fund must automatically pay a benefit. Rather, the fund must properly exercise its discretion by considering the relevant factors and discarding irrelevant considerations.

10. Many funds also provide what is called an ill-health early retirement benefit, in terms of which a member below the age of 55, who is therefore not entitled to an early retirement benefit, provided he meets the definition of disability as contained in the fund rules, may receive a benefit. In such an instance, the fund

rules permit the payment of essentially a retirement benefit in the form of a pension to the member prior to age 55. Some funds, who have this benefit and a disability benefit, will often stipulate that this benefit is only payable if the disability claim within the fund or in terms of an outside scheme is rejected. In defined benefit funds, in the calculation of these benefits, as the member is retiring prior to the anticipated retirement age, an early reduction factor as outlined in the fund rules is normally applied to the benefit.

11. With regard to the use of actuarial assumptions, disability benefits payable by defined benefit pension funds, which are outsourced/transferred to an insurer require the fund actuary to calculate the benefit. The calculation involves fixed elements as well as unknown variables, which the actuary is required to quantify. This type of benefit is commonly known as the member's actuarial reserve value or "ARV". Put differently, ARV is the future liability of the fund to pay the benefit over the remaining life time of the member. To calculate the ARV (especially where the member elects to transfer his ARV to an

insurer of his choice), the actuary will have regard to the member's final salary and years of service, which can be regarded as fixed elements that are easily determined with reference to the rules and actual data. However, the actuary must also consider future events such as:

- inflation rate;
- fund investment return rate;
- pension increases; and
- how long the member will live (mortality rate).

In a reported judgment issued by the Adjudicator, the member was employed in a government department and at the age of 54, was declared permanently disabled due to an immune system failure. She was entitled to a disability pension and elected to transfer her benefit to an insurer. In determining her benefit (transfer value in the form of an ARV), the fund, through its actuary, had regard to the mortality tables, in terms of which females were assumed to live until age 82.

12. However, for the purposes of computing her life expectancy, the fund fictionally assumed that she was 65 years of age (even

though she was only 54 years old). The fund adopted a policy whereby any person in receipt of a disability pension was fictionally assumed to be 65 years of age, regardless of the actual age or nature and extent of the disability. The purpose of this assumption according to the fund was to reflect the generally lowered life expectancy of permanently disabled members. The effect of this assumption was to reduce the mortality rate (in this case by 11 years), resulting in a lower benefit being transferred. The Adjudicator held that this approach was unconstitutional. While he accepted that general mortality tables are necessary, this is not the case for a group of permanently disabled persons. This group is not homogenous and there will be enormous variations with reference to age, nature of disability, impact of disability on general health, impact on mortality, gender differences *etc*. Thus, the fund was directed to establish a mortality factor appropriate to the complainant having regard to her particular circumstances, with reference to medical and other evidence.

13. The above case illustrates that actuarial assumptions made by fund actuaries are not beyond scrutiny. Fund trustees must ensure that these assumptions are in accordance with the principles outlined in our Constitution. Members in receipt of such benefits must firstly obtain the calculation of the ARV (including all assumptions made by the actuary) and carefully examine them and ensure that they are not unlawfully prejudiced by them.

14. It is not possible today, to have a discussion on disability benefits in the context of retirement funds without examining the current pension reform process. Again, it is important to emphasize that to date, although three discussion papers have been issued, the final outcome of our pension system is far from complete. In fact, it has only begun. Nevertheless, it is useful to very briefly examine some of the comments and suggestions with regard to disability benefits. Firstly, the Taylor Committee of Inquiry in 2002 already recommended the payment of disability benefits by retirement funds and proposed

that a minimum disability benefit equal to an income of 60% of the member's earnings before disability be compulsory.

15. In terms of the first discussion paper issued by National Treasury in 2004, several proposals were made regarding disability benefits and the most important of them are as follows:

- It was recognised that certain provisions of the Income Tax Act and Pension Funds Act have inhibited the inclusion of some type of disability benefits. For very large employers this did not matter because the employer could in a cost effective manner access disability benefits through a policy between the employer and an insurer. However, this is not necessarily cost effective for smaller employers.

- There was also recognition that the probability of death or disability rises as income falls. If any one obtained such cover individually, the affluent would get cover cheaper and the poor paid relatively more. By expressing the premium for a group such as a retirement fund in the form of a

percentage of payroll-everyone pays the same rate. This would benefit low-income workers.

- The task team preferred that disability benefits should be taken in the form of income with a modest proportion of the benefit available in the form of a lump sum.
- Retirement Funds be permitted to pay an income on temporary and permanently disability directly to the disability pensioners without losing its status as an approved fund for tax purposes.
- It is important to state that in 2004, the task team felt that no minimum benefits are prescribed as the nature and level of the benefit should be negotiated amongst the parties concerned.
- Finally, the regulator should be obliged to establish an actuarial review committee comprising of experts and other relevant stakeholders, which will be tasked amongst other things to determine the standard to which the fund valuators would be required to comply, including a requirement that any fund which self insurers disability risks, maintain a prudent level of contingency reserve

assets consistent with the capital requirements of a long term-insurer.

16. Subsequently, National Treasury issued a second discussion paper in February 2007 and again its useful to repeat some of the observations with regard to disability benefits provided by retirement funds. Firstly the discussion paper essentially highlighted 4 key objectives for reform namely, increasing coverage, whereby it was necessary to expand the coverage of South Africans saving for retirement and having access to these benefits. Secondly, promote a savings culture within South Africa. This was recently re-iterated by the Minister of Finance. Thirdly, a move away from early withdrawal benefits as historically this left people with inadequate income in retirement and finally there was a general aim at reducing cost with the view to pursuing economies of scale to reduce these costs.

17. This paper also suggested the establishment of a mandatory National Social Security Fund. There would be mandatory

participation in a National Social Security Fund up to an agreed earnings threshold, with such a fund providing a basic disability benefit. The paper recognised that for higher income employees, adequate income replacement due to disability may necessitate supplementary contributions to occupational pension funds and individual retirement funds. As with the previous discussions papers, again there was an emphasis on income payment as opposed to lump sum payment for a variety of reasons.

18. In September 2007, the Department of Social Development issued a discussion paper entitled Reform of Retirement Provisions. The Department firstly acknowledged that any mandatory retirement arrangement should incorporate provisions for post retirement medical aid scheme contributions as well as death and disability cover. Income protection should be designed to prevent poverty due to the death or disability of the breadwinner. Furthermore, it was suggested that the full retirement framework should without exception, be subject to adequate regulation, oversight and governance. It was

specifically stated that all organisations offering insurance, whether it is through a government, quasi-government or private organisation, must be subject to a system of regulation. In line with the suggestions made by National Treasury, the NSSF or any compulsory fund will also be required to provide a minimum death and disability cover.

19. From the various proposals contained in the discussion papers, there is no doubt that the drafters view disability benefits as an integral and an important part of a retirement fund and from the various principles advanced, there is no doubt that in the future it will be compulsory to have disability benefits. The preference of income payment over lump sum payment has been clearly emphasized if not decided already. [**comment**]

20. In the context of commercial funds such as retirement annuity funds and preservation funds, the provision of a disability benefit is not normally provided for. In terms of the Income Tax Act, a retirement annuity fund is defined in Section

1 of the said Act to provide certain benefits. For example, the section provides that the rules of the fund should provide that where a member who has become permanently incapable through infirmity of mind or body from continuing his occupation, before he reaches the age of 55 years, he may receive a benefit. Many retirement annuity fund rules therefore have a clause to the effect that members shall not be entitled to a benefit prior to retirement or death and the only other instance in which a benefit may become payable, is in the event of permanent disability. In the case of a RA fund, there is no employment relationship necessary for participation in the fund, thus the disability definition does not always refer to the occupational requirement and simply states that the member be permanently disabled. Without the reference to the employment relationship, it is not entirely clear what this means. Hopefully this issue will be clarified in the near future.

Participating Employers under Scrutiny in Disability Claims

1. The evaluation of disability claims by retirement fund boards and insurers, where the benefit has been reinsured, has been the subject of several rulings over the last 10 years.

2. In occupational retirement funds, the disability benefit is normally payable upon the termination of the employment contract as a result of the member being unable to perform his own or similar occupation or other criteria as defined in the rules of the fund. The aim of my talk is to examine the consequences of where the participating employer fails to inform the fund of the disability claim or where there is a late notification as a result of which the fund is unable to pay the disability benefit. [**Parts of this aspect of the speech were published in the *Industrial Law Journal* Vol 29 January 2008 at pp 51 – 57.**] I intend to examine the approach adopted by the Adjudicator in three specific cases, where the participating employer in each instance failed to fulfil its obligations, by not informing the fund of the disability suffered by the member, resulting in the member suffering prejudice. In

my view, these three cases represent an excellent sample of the conduct of employers in disability claims and a reflection of the legal position adopted by the Adjudicator's Office over the last 10 years.

3. In the matter of *Namane,* on 1 October 2003 the complainant commenced employment as a driver with the employer and simultaneously became a member of the fund. During his employment, the complainant contracted tuberculosis and other related ailments and was unable to continue as a driver and his services were terminated. The employer acknowledged that the complainant was suffering from tuberculosis and other related conditions but argued that the complainant's employment was terminated due to poor attendance. Therefore, the employer did not consider the complainant in the words of the employer "a disability case" and regarded his termination as an ordinary cessation of the employment contract.

4. The fund in turn did not consider a disability claim and instead paid the complainant a withdrawal benefit of just over a

R1000.00. Now at this point it is important to emphasize that withdrawal benefits payable by pension funds normally consist of the member's and employer's contributions less cost plus investment returns. The cases generally reveal that this benefit in most instances will be substantially less generous than a disability benefit, which as already stated, is usually calculated as a multiple of the member's pensionable salary.

5. The fund contended that it had acted in accordance with the instruction contained in the withdrawal notification form submitted by the employer. This is a notice completed by the employer informing the fund that an employee's employment contract has been terminated. It is also contains general information such as the last day of service and the member's final pensionable or annual salary. This information is used by the fund to determine the type of benefit payable.

6. The complainant was unhappy with the fund's refusal to pay a disability benefit and in essence argued that he contracted

tuberculosis and other related ailments while in service and was unable to perform his duties as a driver.

7. The Adjudicator examined the rules of the fund, from which it was clear that if a member becomes injured, and as a result is permanently absent from work, then a disability benefit consisting of the member's fund salary multiplied by a factor of 1 in this case was payable. It was also common cause that when the complainant's employment contract was terminated in January 2004, no application for disability benefits was submitted by the employer to the fund.

8. It is now trite law that in a occupational pension or provident fund, the participating employer at the very least owes a duty to act in good faith towards its employees. In this regard it is useful to repeat the remarks of Judge Willis in *Mine Employees Pension Fund*, where he stated "It is important to remember that pension funds and employees' membership thereof form an integral part of the employee relationship (see eg *Lorentz v Tek Corporation Provident Fund and Others* 1998 (1) SA 192 (W) at

211A-232J). The right to a pension benefit arises out of the employment contract and is part of the consideration that an employee receives in return for rendering his or her services. As a result, it gives rise to an implied contractual obligation on the employer to act in good faith when exercising rights and obligations in relation to pension benefits (see eg *Imperial Group Pension Fund Ltd and Others v Imperial Tobacco Limited and Others* [1991] 2 All ER Ch).

9. Returning to the facts of the case before the Adjudicator, he held that this duty as outlined by Judge Willis is more compelling in a commercial umbrella fund, where the employer firstly determines whether to participate in the fund and the range of benefits payable. Furthermore, unlike an ordinary occupational pension or provident fund, the Board of Management does not consist of employee-employer representatives and in light of this fact, there is no doubt, that the participating employer must play a more active role in the general protection of members in this type of fund. Therefore, the Adjudicator concluded that where the fund rules provide for

a disability benefit and member suffers from injury or disease, the employer is obliged to refer the claim to the fund. Hereafter the fund must exercise its discretion in respect of payment of the disability benefit in terms of the rules. Thus, it is not up to the employer to determine if a member is entitled to a disability benefit.

10. On the fact of this case, it was not clear to the Adjudicator why the employer failed to submit a disability claim to fund. In terms of the rules of the fund, a claim had to be submitted to the insurer within three months of the event giving rise to the disability claim. As the claim was not submitted to the insurer, the Adjudicator held that the appropriate relief in this matter would be to order the employer to now submit the claim to the fund and/or insurer and for the board of the fund to determine whether the complainant would have been entitled to a disability benefit. Based on the reasoning of the High Court in the *Orion* matter, the Adjudicator finally concluded that in the event of the fund holding that the complainant would have been entitled to a disability benefit, the employer would be liable to

pay that disability benefit, less amounts already paid to the member, plus interest essentially in the form of a damages award.

11. From the evidence before the Adjudicator, it is clear that he was not in a position to determine whether the member was permanently disabled as defined in the fund rules and therefore was effectively forced to refer the matter back to the fund.

12. Turning now to the case of *Fortuin*. In *casu*, the complainant commenced employment with the employer on 1 April 1999 and simultaneously became a member of the respondent fund. In about 2002 the complainant's right leg was amputated and on 1 October 2002 his employment contract was terminated. The employer subsequently informed the fund that the complainant had resigned from service. The fund in accordance with the employer's instructions determined that the complainant was entitled to a cash benefit of roughly R4000.00, which was then paid to the complainant. The complainant was unhappy with the decision of the fund and claimed that he was entitled to a

disability benefit. He furthermore stated that he had not resigned from service. In fact, in his complaint he specifically stated “Ek sal voorgee die fout is by die werk. Die company het aan die provident fund verkeerde inligting verskaf. Ek het nie resign nie maar die dokter het my permanent afgeboek van die werk.” Roughly translated the complainant indicated that he did not resign from service but rather that the doctor had permanently medically boarded him as a result of which his employment contract was terminated. [**comment**]

13. Once again, regarding the liability of the fund, the Adjudicator held that the administrator relied on the employer to provide it with information to determine the type of benefit payable to the member. In the instant matter, as the fund was again advised that the member had resigned from service it had correctly processed and paid a withdrawal benefit.

14. On an inspection of the rules, it emerged that they provided for a disability benefit. However, in terms of the provisions of the insurance policy and the rules, the fund is required to inform

the insurer within 9 months of the occurrence of the disability to enable it assess the claim. As no claim was submitted by the employer to the fund, the fund was not in a position to notify the insurer to assess the claim.

15. In this matter, the Adjudicator took the view that it is clear that the employer did not act in good faith and in the member's best interest when it advised the fund that the member resigned from service. Furthermore, in light of the fact that the member's leg was amputated and his general service ability reduced/impaired, the employer should have submitted the claim to the fund. Once again, as there was insufficient evidence to determine the merits of the disability claim, the Adjudicator again concluded that the appropriate relief would be to order the fund to consider the disability claim and in the event of the fund concluding on the merits that the complainant would have been entitled to a disability benefit, then the employer would be liable for the payment of such benefit less amounts already paid. An order to this effect was issued.

16. Turning now to the case of *Swanepoel*, on 1 July 1991 the complainant was employed as a risk inspector at the employer's factory. His primary functions were to control access to the property, patrolling of key points in the plant, transportation of the workers to and from the factory, testing of alarms, depositing monies at the bank, payment of accounts, and the investigation of any incidents at the factory. At the same time that he commenced service, the complainant became a member of the pension fund. In about 1997, the complainant was advised by the employer that he could not drive the employer's vehicle because of numerous dangerous incidences that had occurred while he was on duty. Subsequently, medical examinations revealed that that he was diagnosed with a condition known as sleep apnoea. The employer classified the complainant as being partially permanently disabled in that he was unfit to continue in the current occupation but fit to continue employment in any alternative occupation. The employer advised the complainant that while he could not perform his normal duties at work but could still do other work. As a result, the employer decided not

to submit a disability claim to the fund and stated that the complainant had resigned from service on 31 November 1997. As with the previous two cases, the fund again paid the resignation benefit consisting of the member's accumulated contributions and again failed to consider whether that member was entitled to a disability benefit.

17. Regarding the merits of the claim, the Adjudicator firstly held that in terms of the rules of the fund, a disability benefit and/or an ill-health early retirement benefit are payable under certain circumstances. However, one of the requirements for the payment of the latter benefit required the employer to direct that a member be retired any time prior to his normal retirement on the grounds of ill-health. Furthermore, before making such a direction, the employer must be satisfied that the member is permanently disabled as a result of sickness or accident not caused by his own fault, to the extent that he is prevented from returning to the position in which he was employed immediately prior to his disablement.

18. In this matter, the Adjudicator again held that it was common cause that the complainant was permanently disabled to the extent that he could not return to his normal post. Furthermore, from the evidence it appeared that the employer's reluctance to submit an ill-health claim was essentially based on a disability management agreement concluded between the respective trade unions and the employer, which provided for a more onerous provision that requires the claimant to be incapable of working in his own or any other occupation. The Adjudicator was critical of the employer's approach and held that it should have been aware that the ill-health benefit is determined by the rules of the fund and not the provisions of a disability management agreement. Therefore, it was held that an appropriate order again would be to direct the employer to submit a disability and ill-health early retirement application to the fund. Once again in the event of the fund concluding that the complainant was entitled to either of the benefits, the employer was then held liable to pay those benefits.

19. In all of the above rulings, unfortunately or fortunately depending on which side you fall on, there was insufficient evidence on the merits of the disability or ill-health applications in order for the Adjudicator to make a ruling on the merits of the disability application. Thus, in each instance, the matter was effectively referred back to the fund for a decision on the merits. On a survey of all the cases, this appears to be the general position adopted by the Adjudicator's office.

20. However, there are isolated examples of where there is sufficient evidence on the merits and the Adjudicator has effectively substituted his/her decision for that of the board. In *Myeza*, the complainant was injured while on duty and was declared permanently disabled by an orthopaedic surgeon. In terms of the disability policy issued to the fund to cover the risk benefit, a claim had to be submitted within six months of the date of disability. As the employer failed to inform the fund of the disability within the six month period, the claim was rejected by the insurer. In this matter, the Adjudicator was satisfied on the evidence before him that the complainant was permanently

disabled as defined in the fund rules and therefore ordered the employer to pay the value of the disability benefit in the form of a damages award to the complainant.

21. In the context of disability claims, all the above cases clearly reveal that there is an important duty placed on the participating employer in an occupational pension or provident fund to timeously inform the said fund of the disability suffered by the member. Furthermore, it is critical that employer does not usurp this important discretion usually reserved for the board or another functionary within the fund and determine whether the member is entitled to a disability benefit. Put differently, where the member is suffering from a physical or mental infirmity, which has resulted in the termination of the employment contract, the employer is well advised to inform the fund of the infirmity so that the fund may consider the disability or ill-health benefit. As stated, the employer's duty in this regard is to timeously submit a disability claim to the fund. It does not necessarily have to wait for a medical practitioner to first express an opinion in this regard before doing so.

22. Many funds reinsure their risk cover with insurance companies. The insurers require that they be notified within a specific time period of the date of disability. This in turn allows the insurer to consider the claim within a reasonable period of time immediately after the event giving rise to the infirmity and where necessary request that the member undergo further medical evaluations. These time periods are normally captured in the fund rules and the failure to submit a claim within the specified period will result in the claim being rejected on this basis alone notwithstanding the merits of the claim. As the rulings in no uncertain terms demonstrate, the failure to submit a claim timeously may result in an adverse damages award being made in favour of the complainant against the employer.