THE (ALMOST) AFTERMATH OF SURPLUS APPORTIONMENT

Distinguished lawyers, ladies and gentlemen

There has been much debate concerning those funds whose surplus schemes were submitted and approved and who have subsequently encountered errors in their approved schemes. The debate has revolved around what should the funds then do?

Should a fund apply to a High Court having jurisdiction to review and set aside the Registrar's approval of its surplus scheme, or should the fund lodge an appeal to the Appeal Board of the FSB ?

On 1 February 2010, in an article published in the "Without prejudice" Law Magazine.[1], the learned attorney made reference to the Registrar's "position" and the apparent "insistence" of my office on the review-application route being followed. The conclusion reached by the author is that it will be "*a risky decision for a fund to take a chance in the High Court*", the danger being that "*someone might successfully challenge the Registrar's reluctance to make use of appeal procedure*". I do not intend to use this forum as a means of responding to the contents of the article (it is after all, as you lawyers will point out, just an opinion), but rather to enlighten you about the "position" that my office has adopted in dealing with funds which have encountered errors in their schemes subsequent to approval.

[1] The article was entitled "The language trap" and the author is Pasno N Nyachowe, an attorney in the employ of Bowman Gilfillan attorneys. A copy of the article is attached.

In our view, the legally correct, most efficient and cost effective remedy must be implemented. All of this must take place within the framework of the law. Let us firstly examine , therefore , the significant aspects of surplus apportionment , having regard to what the Legislature intended to achieve:

1. The approval of a fund's surplus apportionment scheme is an administrative act by the Registrar.

2. Upon approval, a scheme confers rights and reasonable benefit expectations upon those stakeholders to whom surplus has been apportioned.

3. Once a scheme is approved, the Registrar is *functus officio*.

4. There is no provision in the Pension Funds Act which allows the Registrar to revisit his decision to approve

a scheme, such as the power of the Registrar to set aside section 14 certificates.[2]

5. An approved scheme that contains errors of fact cannot and should not be implemented. It should be set aside as expeditiously as possible to ensure that a revised scheme is submitted, considered and approved.

6. The setting aside of an incorrect scheme will bring about legal certainty for the fund and its stakeholders and will open the door for the correct scheme to be approved and implemented in the interest of stakeholders.

7. Where material errors of fact are uncovered in a SAS,the remedy of a review will be available to both the Registrar and any party prejudicially affected thereby.

[2] Section 14(6) of the Pension Funds Act

Whilst it is undoubtedly correct that the review and appeal procedures are the only possible remedies to address the setting aside of an approved surplus scheme, the question that must be answered in each instance is whether or not an appeal is necessarily an internal remedy that is available to a fund whose scheme contains errors of fact. In the past, criticisms leveled against the Registrar in respect of the perceived "position" that he had adopted seem to have been based solely on an analysis of the provisions of PAJA (the Promotion of Administrative Justice Act)and more particularly the requirement that all internal remedies must first be exhausted before review proceedings in a Court may be instituted. The following two aspects seem not to have been factored into the equation:

1. The exact nature of what the Registrar approves in terms of a surplus scheme; and
2. The jurisdictional requirements of section 26 of the Financial Services Board Act for an appeal.

With regard to the first point, a surplus scheme is approved in accordance with the provisions of sections 15B(8) and (9) of the Act. The Registrar's approval is in respect of the apportionment of actuarial surplus amongst the different classes of stakeholders.

Where the distributable surplus in a fund is utilised exclusively for the top-up of benefits for pensioners and former members, the Registrar approves a first-tier distribution of the fund's surplus. The Registrar does not consider or approve the individual payment or calculation of the increased benefit payable to each former member or pensioner. The Registrar approves

surplus apportionment on a globular or stakeholder level.

The same applies to a second-tier distribution where the board of a fund apportions the residual surplus between the various classes of stakeholders whom it had determined should participate in the apportionment. The apportionment scheme for the distribution of residual surplus expresses the apportionment of surplus to the different stakeholders as a percentage of the total surplus. This is what the Registrar considers and approves, namely the distribution of surplus on a globular or stakeholder level.

This approach by the Registrar was in fact confirmed by the Appeal Board in the determination of the Southern Sun Group Retirement Fund.[3]

[3] The determination was issued on 30 April 2008.

The second aspect that must be considered is the requirement of section 26 of the FSB Act that a person "who is aggrieved" by a decision of a decision-maker (such as the Registrar) may appeal against that decision to the Appeal Board of the FSB.

Who is an aggrieved person? And what does it mean?

Our courts have decided that "*a person aggrieved*" is someone against whom a decision has been pronounced which has wrongfully deprived him of something, or wrongfully affected his title to something.[4] Such a person is someone whose legal rights have been infringed – he is a person harbouring a legal grievance and not just a person who is disappointed or disgruntled.[5]The Appeal Board itself has on occasion pronounced on the content of this jurisdictional

[4] Ex Parte Sidebotham (1880) 14 SHB 458 (AC) per James LJ

[5] See Janse van Rensburg v The Master 2004(5) SA 173 (T) at 180, LL Mining Corporation v Namco (Pty) Ltd (in liquidation) and Others 2004(3) SA 407 (C) and Francis George Hill Family Trust v South African Reserve Bank & Others 1992(3) SA 91 (AD) at 102C-D.

requirement in, for instance, the appeal matter of Three Diamonds Trading 35 (Pty) Ltd v Registrar of Financial Services Providers.

So, in order to have an internal remedy that must first be exhausted, it is necessary to determine whether or not a prospective appellant will satisfy the jurisdictional requirements of section 26 of the FSB Act. That enquiry is a factual enquiry which must be determined with reference to the facts of each particular case.

Allow me now to briefly discuss the various cases that have presented themselves in this regard.

The very first scheme in which errors of fact were uncovered subsequent to its approval was that of the **ICL South African Pension Fund**. The error subsequently uncovered by the fund was that its actuarial surplus was understated as a result of an option that was valued as nil, but which had an actual value of R29 million. The

approved scheme comprised both a first tier and a residual distribution.

The Fund made it clear in its founding papers that neither the Fund nor the board had suffered any legal grievance as a result of the Registrar's approval of the scheme. Hence the internal remedy of an appeal to the Appeal Board was not available to the Fund. If you will allow me, I shall put it a little more bluntly: Neither the Fund nor the board can be aggrieved persons where they submitted the incorrect information to the Registrar.

In the matter of the **Mount Nelson Hotel Pension Scheme** a similar application for the review and setting aside of the Registrar's approval of the fund's surplus scheme was served on the FSB. The error of fact uncovered was that incorrect pensioner details were used by the fund's valuator when calculating the actuarial surplus available for distribution. This resulted

in the distributable surplus being understated by approximately R500 000.

When considering a surplus apportionment scheme, the calculations done by a valuator are not something with which the Registrar is presented. Whilst the basis upon which the liabilities of a fund is determined is provided to the Registrar, it is simply the formula (or put differently the "result" of the valuator's calculations). The particular application of the formula to the specifics of a fund is not something that the Registrar interrogates to see for instance whether or not the valuator made any errors.

Once again: The Fund could not have been aggrieved as a result of the Registrar's approval of the scheme when the fund itself submitted the incorrect scheme.

The application was granted by the High Court on an unopposed basis after the Registrar indicated in a letter to the Fund that an appeal under section 26 of the FSB

Act is not available to it, as the fund was not aggrieved by a decision of the Registrar but rather as a result of its own actuary and consultant having made an incorrect calculation.

Two further applications for the review and setting aside of the approval of surplus schemes were received : one from the **Grinaker Group Pension Fund** and the other from the **Sentrachem Group Pension Fund**.

- In respect of the Grinaker scheme it was uncovered that the Fund's actuary had made an error in the calculation of the Fund's liabilities. The effect of the error did not affect the amount of distributable surplus, but was such that whilst the initial approved scheme comprised both a first tier and a residual distribution, a revised scheme would only cover a proportional first tier distribution to former members.

- In respect of the Sentrachem scheme it was discovered that the valuation upon which the surplus scheme was based had failed to provide properly for the transfer values payable in respect of some members who had ceased to be contributory members of the Fund at a particular date, but whose transfer applications had not yet been approved. The effect of the error was that the fair value of assets was overstated by an amount of R16.5 million.

In neither of the two applications did the funds address the appeal procedure under section 26 of the FSB Act or the requirement to first exhaust an internal remedy before embarking upon a review application. No doubt, both funds were advised that they would not satisfy the jurisdictional requirement of an "aggrieved person" in order to lodge an appeal to the Appeal Board. Both

schemes were set aside on application to the High Court after the Registrar filed answering affidavits in which he indicated that the relief sought was not opposed, but that the errors of fact occurred not as a result of the actions of the Registrar, but rather as a result of the valuators having made incorrect calculations.

My office has already been informed of two further intended review applications to set aside approved surplus schemes.In both instances the legal representatives of the Funds concerned interacted with my office to discuss the nature of the errors and the appropriate remedy.

And this, ladies and gentlemen, has been an approach that I welcome. At the heart of the matter lies the rights and reasonable benefit expectations of the stakeholders. Acting in their interests, my office has been at pains to assist where possible, to do what is necessary to ensure

that incorrect schemes are not implemented, and that they are overturned as quickly as possible. In getting to that point my office has no “preference” in respect of the appropriate remedy to set aside an approved surplus scheme that contains errors.

- What is of importance is that an incorrect scheme cannot be implemented and should be set aside as soon as possible to ensure legal certainty;
- Coupled with legal certainty is the need to satisfy the legitimate benefit expectations of pensioners and former members – people who are waiting for their share of the surplus and to whom even a small benefit allocation might make a big difference;
- In each instance careful consideration is given to the nature of the errors, the effect thereof and whether or not an appeal against the Registrar’s decision to approve the scheme is available. By now you will

appreciate that the jurisdictional requirement of an "aggrieved person" might in most cases be a stumbling block for a fund or its board (being the very persons who submitted the scheme) to take the matter on appeal.

The review application route has, thus far, proved to be the appropriate remedy. Not only that, but it has also proved to be effective as all of the applications mentioned above served before Court within a period of approximately 2 to 3 months after having been issued. This is very quick when compared to simply the procedural aspects applicable to appeals before the Appeal Board –

- an appeal must be noted within 30 days from the date of decision,
- the Registrar must provide reasons within 1 month after the appeal was noted and

- the appellant must file grounds of appeal within 1 month thereafter.

So working simply on these periods an appeal might not even be ripe for hearing at the end of 3 months subsequent to the approval of a scheme. And since the Appeal Board of the FSB is not in permanent sitting, but is convened ad hoc for specific cases as and when matters are ripe for hearing, it inevitably takes even longer to enroll an appeal for hearing. It might well take up to 6 or 8months for an appeal to be heard.

Two further aspects relating to the nature of an appeal to the Appeal Board must be highlighted.

The first is whether a person who has not received a correct amount of money in respect of an approved surplus scheme can appeal against the approval of the scheme to the Appeal Board. Can such a person be said to be aggrieved as a result of the Registrar's approval of

the scheme? This is not a situation with which the FSB has been confronted as yet, but one of which we are acutely aware since complaints are received virtually on a daily basis about the allocation of surplus. Although, as I have indicated, each case must be determined with reference to its peculiar facts, it would seem that where an incorrect amount is paid to a former member or allocated to a pensioner or other stakeholder based on an error of calculation, the appeal remedy would also not be available to such a person. The reason? The Registrar does not consider or approve the calculations of benefits payable to individual stakeholders. He approves the apportionment of surplus (expressed as a percentage) to the classes of stakeholders. To hold that individual stakeholders are aggrieved at the Registrar's approval of a fund's surplus scheme will open the floodgates and literally incapacitate the Appeal Board of the FSB. To illustrate the point, my office has recently been

approached by a fund who incorrectly implemented an approved scheme. The fund's administrator made a mistake in calculating the amounts payable to individual stakeholders – some were paid too much, others too little and some who were not entitled to a minimum top-up were even paid an enhancement. When the error was uncovered, some even suggested that the scheme should be set aside and amended to be brought in line with what was paid. Having considered the matter my office was at pains to point out that there was no error in the scheme that was approved and that it should be implemented as is. The fact that the fund may have a shortfall to effect the balance of payments due in terms of the scheme is an altogether different issue that has to be addressed by those responsible for the error.

The second point in respect of the nature of appeals is that prior to February 2009 such appeals were appeals in

the wide sense, that is, they amounted to a total re-consideration of the matter and the Appeal Board (having stepped into the shoes of the Registrar) was at liberty to take into account new and further information that did not inform the Registrar's original decision.

However, since the promulgation of the Financial Services Laws General Amendment Act, No 22 of 2008, this is no longer the position. Appeals are now narrow as understood in the traditional sense and must be decided on the written evidence, factual information and documentation submitted to the decision-maker before the decision, which is the subject of an appeal, was taken. Further or new evidence (such as the errors subsequently uncovered in surplus scheme) my only be introduced by an appellant on application and on good cause shown. The FSB Act now provides that if such further evidence or information is allowed into the

record of appeal, then the matter must revert back to the decision-maker concerned for re-consideration and the appeal is deferred.

So even if one can arguably conceive of the notion that there might be a way in which the existence of the errors may be introduced on appeal for reconsideration by the Registrar, the Registrar has not been granted the right to set an approved scheme aside. The Act provides that the Registrar may take a “final decision” once he has considered the further evidence. However, that “final decision” entails an indication by the Registrar whether he stands by his original decision (oppose the appeal) or whether he will abide the decision of the Appeal Board (not oppose the decision) should the appeal proceed. And whilst the introduction of the errors in a scheme by way of additional information in an appeal record may be possible, it will not address or solve the jurisdictional

requirement that the person appealing must be a person aggrieved at the Registrar's decision. I raise this issue, but point out that all of the review applications mentioned earlier were instituted prior to the 2008 amendment of the FSB Act. They were all instituted before the nature of the appeal and the appeal procedures were changed.

In conclusion, I assure you that my office takes the errors uncovered in surplus schemes very seriously. We appreciate that such errors do occur and there will undoubtedly be many more schemes in which such errors are uncovered in the future. Careful consideration is given to each case to determine exactly what would be the legally correct remedy. Review applications to the High Court have turned out not only to be the correct, but also the most expedient and cost effective remedy.

The remedy must be expedient because stakeholders' rights and reasonable benefit expectations must be satisfied and I am afraid patience in the public space has run out with both the Regulator and the Retirement Fund industry in respect of the finalisation of the surplus legislation that was enacted more than 9 years ago.

The remedy must also be costs effective – someone must pick up the costs for the errors – and in this regard the Registrar's position is also clear – the stakeholders in any given scheme should not be prejudiced by the errors of others.

And in that regard, ladies and gentlemen, you, as pension lawyers, have a critical role to play in determining who should be held responsible, which is something that lawyers are especially good at ,as I have learnt from the many criticisms leveled against my office!

I THANK YOU AND TRUST YOU ENJOY THE REST OF YOUR CONFERENCE IN THIS WONDERFUL PART OF OUR COUNTRY.