THE SUPREME COURT OF APPEAL OF SOUTH AFRICA

JUDGMENT

Case No: 288/09

In the matter between:

REGISTRAR OF PENSION FUNDS Appellant

and

ICS PENSION FUND Respondent

Neutral citation: *Registrar of Pension Funds v ICS Pension Fund* (288/09) [2010] ZASCA 63 (4 May 2010)

Coram: HARMS DP, NUGENT, MLAMBO and MALAN JJA and THERON AJA

Heard: 12 MARCH 2010

Delivered: 4 MAY 2010

Summary: Pension Funds Act 24 of 1956 – actuarial surplus – section 15F – approval by registrar for transfer of credit in reserve account to employer surplus account – considerations to be taken into account.

ORDER

On appeal from: North Gauteng High Court, Pretoria (Rabie J sitting as court of first instance).

The appeal is dismissed with costs.

JUDGMENT

NUGENT JA and THERON AJA (HARMS DP, MLAMBO and MALAN JJA concurring)

[1] This appeal concerns the application of s 15F of the Pension Funds Act 24 of 1956. We think it is helpful at the outset to trace the background against which that section was introduced into the Act.

[2] Depending upon their structure some pension funds are capable of accumulating an actuarial surplus, which, in broad terms, is the excess of its actuarially valued assets over the actuarial value of its accrued liability towards members and former members.[1] In recent years there have been disputes as to whether such surpluses accrue to the benefit of members or whether they accrue to the benefit of contributing employers.[2] With effect from 7 December 2001 ss 15A to 15K were introduced into the Act to deal with such surpluses. Together those sections are commonly referred to as the 'surplus legislation'.

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[1] See the definition of 'actuarial surplus' in s 1 of the Pension Funds Act 24 of 1956.
[2] Cf *Tek Corporation Provident Fund v Lorentz* 1999 (4) SA 884 (SCA).

[3] In broad terms s 15B requires the board of every pension fund that commenced prior to 7 March 2002 to submit to the Registrar of Pension Funds, within a specified time, a scheme for the apportionment of any actuarial surplus that it might have. The board is required to determine who may participate in the apportionment, which must include existing members and former members, and must then apportion the surplus as between all the participants, in accordance with various principles that are reflected in the section.

[4] The surplus that is apportioned to members and former members must be credited to a 'members' surplus account' and the surplus that is apportioned to the participating employer must be credited to an 'employer surplus account'. The use to which the credits in those accounts may be put is circumscribed by s 15D and s 15E respectively. Section 15C deals with the allocation of surpluses that arise after the legislation took effect.[3]

[5] In this appeal we are concerned only secondarily with s 15B but primarily with s 15F. Section 15F deals with actuarial surpluses that were apportioned before the surplus legislation took effect and in particular to an actuarial surplus that had been allocated to a 'reserve account' of the fund. A 'reserve account' is defined in the Act to mean a 'contingency or investment reserve account' and will ordinarily have been under the control of the contributing employer.

[6] Section 15F allows the board of a fund to apply to the registrar to approve the transfer of all or some of the credit balance in an existing reserve account to the employer surplus account. Once so transferred it is available to be used by the employer within the limits circumscribed by s 15E. If the application is refused, whether in whole or in part, the portion of the credit that is not transferred will be

[3] Sections 15G – 15K have no relevance to the appeal.

subject to distribution, under s 15F(3), as if it were actuarial surplus that is distributable under a s 15B scheme.

[7] Under s 15F(2) the registrar may approve such a transfer from the reserve account to an employer surplus account if he or she

'is satisfied that the allocation of actuarial surplus to [the reserve account] was negotiated between the stakeholders in a manner consistent with the principles underlying sections 15B and 15C.'

[8] In this case the board of the ICS Pension Fund, the respondent, applied to the registrar under that section to transfer to its employer surplus account part of the credit balance in a reserve account. The amount that was sought to be transferred was the then balance of a portion of an actuarial surplus that had been allocated to the employer in 1997.

[9] The registrar declined to approve the application whereupon the fund appealed to the board of appeal established by s 26 of the Financial Services Board Act 97 of 1990.[4] The board dismissed the appeal and the fund applied to the High Court at Pretoria to review that decision under the Promotion of Administrative Justice Act 3 of 2000. The high court (Rabie J) found that the board of appeal had materially misdirected its enquiry and set aside the decision. It chose not to remit the matter for reconsideration by the board of appeal but instead to assume to itself the role of the board and to substitute its own decision for that of the board. Having assumed to itself that function the high court upheld the appeal against the registrar's decision and directed the registrar to approve the application. The registrar now appeals against those orders with the leave of that court.

[4] An appeal under s 26(2) lies against a decision of the 'executive officer'. Under s 3 of the Pension Funds Act the 'executive officer'referred to in s 26(2) of the Financial Services Board Act is also the Registrar of Pension Funds.

[10] It was common cause in the court below and in this court that the decision of the board was reviewable under the Promotion of Administrative Justice Act, that the court below correctly found that the board of appeal had materially misdirected its enquiry and correctly set the decision aside, and that the court below correctly chose not to remit the matter to the board of appeal but instead to substitute its own decision. That being so, the reasons that were given by the board of appeal for its decision, although instructive, are not material to this appeal. We are concerned only with the substituted decision of the court below and the reasons that it gave for that decision.

[11] It is not disputed that an appeal against the decision of the registrar is not an appeal in the strict sense. The board of appeal, and hence the court below in this case, is called upon instead to consider the matter afresh, upon all relevant material that is placed before the board of appeal. Indeed, it was the failure of the board of appeal to recognise that distinction, which pervaded all its reasoning, that resulted in its decision correctly being set aside.

[12] We have pointed out that under s 15F(2) the registrar may approve a transfer from an existing reserve account to an employer surplus account if he or she is 'satisfied that the allocation of actuarial surplus to [the reserve account] was negotiated between the stakeholders in a manner consistent with the principles underlying sections 15B and 15C.' If the allocation of surplus to the reserve account indeed satisfies those requirements then, notwithstanding the use of the word 'may', the registrar has no discretion to refuse the application, but is obliged to approve the transfer.

[13] The manner in which portion of the actuarial surplus that existed in the fund before the surplus legislation came into effect was allocated to the reserve account in this case needs to be seen in the context in which the allocation was made.

[14] There are two kinds of pension funds (at least for present purposes). One is a ‘defined benefit fund’. In such a fund members become entitled to fixed benefits that are circumscribed by the rules, irrespective of the performance of the investments that are made by the fund. If the investments of the fund produce insufficient income to meet those obligations then the employer underwrites the shortfall. If the investments that are made by the fund perform better than expected a surplus will accrue to the fund. The other is a ‘defined contribution fund’. In such a fund the benefits that are payable to members are directly linked to the performance of the investments that are made by the fund. If the investments perform well then the benefit will accrue to members directly and they will likewise bear the brunt of poor performance. Such a fund thus relieves the employer of the risk of poor performance of its investments and likewise promises to members the direct benefit of sound performance.

[15] Prior to 1 November 1996 the ICS Pension Fund was a ‘defined benefit’ fund. In about August 1996 the board of the fund decided to create a ‘defined contribution’ section. Members of the fund were invited to elect whether to remain in the ‘defined benefit’ section of the fund or to transfer to the ‘defined contribution’ section that was to be created.

[16] The decision to create that new section of the fund is really incidental to this appeal. What is relevant is that simultaneously with creating that ‘defined contribution’ section – and no doubt at least partly as an inducement to members to transfer to that section – the board of the fund distributed part of its accumulated surplus to members who elected to transfer.

[17] The implications of the election were explained to members and former members by way of an information booklet and oral presentations that were

distributed and made respectively during October 1996. It is not necessary to deal in any detail with the information that was conveyed.

[18] Meanwhile, the board of the fund was reconstituted in November 1996. From that time on the board comprised three members elected by members of the fund, and three members appointed by the employer. At the first meeting of the newly constituted board on 25 November 1996, reports were presented concerning the progress of the creation of the new section and its implications for the fund.

[19] Ultimately, 95 per cent of the active members of the fund elected to transfer to the defined contribution section. At the effective date the fund had an actuarial surplus of R107 393 711. The board of the fund decided to allocate that surplus as follows: 34 per cent was allocated to active members, 22 per cent was allocated to pensioners, one per cent was allocated to a 'contingency reserve'[5] for those members who remained in the 'defined benefit' section, 28 per cent was allocated for use by the employer (credited to an employer-controlled reserve account),[6] and a residual surplus of 15 per cent remained.

[20] Amendments to the rules, allowing for the creation of the defined contribution section with retrospective effect from 1 November 1996, and for the surplus distribution, were submitted to the registrar and registered on 30 December 1997.

[21] On 18 January 2005, after the surplus legislation had come into effect, the board of the fund applied to the registrar to approve the transfer of R25 365 605 from the employer-controlled reserve account to the employer surplus account. Precisely how that amount is made up is not material for present purposes. It is

[5] Precisely what contingencies the allocation was intended to cover do not appear from the evidence.
[6] That allocation, amounting to R30 million, was held in the Employer General Account as a 'ring-fenced reserve' for the use of the employer.

sufficient to say that, substantially, it was the balance that then remained of the actuarial surplus that had earlier been allocated to the employer-controlled reserve.[7] The registrar declined to approve the transfer, on the ground that he was not satisfied that that earlier allocation of actuarial surplus to the reserve account 'was properly negotiated between the stakeholders in a manner consistent with the principles underlying sections 15B and 15C of the Act, as embodied in Circular PF 105 paragraphs 14(a) – (h).'[8]

[22] The registrar later expanded upon that when he said (so far as the reasons that he gave are now relevant) the following:

'(a) In the exercise where surplus was shared between the employer and certain members only, no surplus enhancement was allocated to members preferring to remain in the defined benefit option.

(b) There is no proof of any negotiation between the fund and members or members' representatives.

(c) In the information sent to members, there was no indication of the amount or percentage that would be allocated to the employer.

(d) The enhancement of members who chose to opt for defined contribution, indirectly also benefited the employer due to the transfer of risk from the employer (in the defined benefit arrangement) to the members (in the defined contribution arrangement).'

He also stated that

'[t]he decision by an employer-appointed board to convert from a defined benefit to a defined contribution arrangement, whereby certain risks are transferred from the employer to the individual members, without any disclosure of the amount to be set aside for exclusive use by the employer, cannot be viewed as a decision to negotiate and distribute surplus'.

[23] The registrar's opposition to the transfer really reduces itself to two principal objections, and that is how the matter was approached before us. First, the registrar was of the view that the fund had not established that the allocation had been properly 'negotiated between the stakeholders' as required by s 15F(2)

[7] The allocation of R30 million that had been made in 1997.

[8] As pointed out in *Coca-Cola*, referred to later in this judgment, the circular does not deal with the situation envisaged by s 15F of the Act.

read with ss 15B and 15C. And secondly, he considered that the allocation of the actuarial surplus had not been equitable and was thus not in conformity with those sections.

[24] With regard to the first objection it was submitted on behalf of the registrar that there had been no negotiation at all between the fund and its members and others who had an interest in the allocation. It was submitted that they were simply presented with the prospect of choosing between joining the new section of the fund or remaining in the existing section, to which a proposed allocation of surplus was linked, and put to an election between those alternatives. Secondarily to that submission was the further submission that the relevant participants were not properly informed of the implications of that choice, and in particular were not informed in advance how the allocation of surplus would be made.

[25] What is meant by 'negotiation' in s 15F(2) was considered by a differently constituted board of appeal in *Coca-Cola Southern Africa Pension Fund v Registrar of Pension Funds.*[9] After referring with approval to what was said by Eloff J in *Minister of Economic Affairs and Technology v Chamber of Mines of South Africa*[10] the board of appeal went on to say the following:

'As appears from the above quotation the extent of the need to enter into debate in an endeavour to reach agreement, depends upon the extent of the disagreement between the contending parties. It is obvious that if there is no disagreement it is not possible to conduct a negotiation in the sense in which that word is used in section 15F. Consequently what is contemplated by section 15F is that there must not be a unilateral decision by the board of a fund to allocate actuarial surplus to an employer reserve account without taking account of the views of all interested parties i.e. the relevant stakeholders. To the extent that there are differing views, an endeavour should be made to reach agreement, by entering into debate on the issues on which the relevant stakeholders are at variance.'[11]

And later:

[9] A decision of the board of appeal handed down on 28 August 2006.
[10] 1991 (2) SA 834 (T) at 836G-J.
[11] Para 24.

'It must be borne in mind, when considering what the legislature meant by the words "in a manner consistent with the principles underlying sections 15B and 15C," that when the employer reserve account was established, sections 15B and 15C had not yet been enacted. It could not have been contemplated that the process provided in those sections must have been followed literally. What is required is that the negotiation conformed to the broad principles underlying those sections.

The board of appeal went on to say:

'Naturally a negotiation envisages an understanding on the part of the negotiators of the relevant facts in order for them to reach an informed conclusion. Accordingly one of the principles underlying sections 15B and 15C is that the members and pensioners must be in possession of sufficient information of what it is proposed to allocate to the employer reserve account to enable them to enter into meaningful debate on such allocation should they hold a view that differs from that of the board.'[12]

[26] We find no fault with those general observations, which were adopted by the court below, but with some qualification. So far as the final passage might suggest that it was incumbent upon the board of a fund always to have engaged in discussions with participants in the allocation directly, we do not think that is correct. Precisely how the board of a fund was to 'negotiate' with a large body of participants, if they were not in agreement with the proposal that was made by the fund, was not touched upon in that case, nor does it arise in this case. But we venture to suggest that it would ordinarily be impractical to expect the board of a fund to have dealt directly with a large body of interested parties, who might have had disparate interests, and that a board might instead have been justified in insisting that the participants elect representatives to negotiate on their behalf.

[27] That raises the separate question what is to be expected of the board of a fund where participants in the allocation of surplus had indeed elected representatives who were able to negotiate on their behalf. In *Coca-Cola* it was submitted to the board of appeal that in those circumstances direct

[12] Para 26.

communication with stakeholders was not required. The section is complied with, so it was submitted, if their representatives were in possession of sufficient information to enable them to properly negotiate. In response to that submission the board said the following:[13]

'While this approach would not necessarily in every case amount to compliance with section 15F, we agree that in the circumstances of the present case it is an acceptable approach'.

[28] In general we agree with that conclusion, though whether that will have been adequate in a particular case will necessarily depend upon the particular circumstances. It goes without saying that it will have been incumbent upon the board of the fund to have ensured that the representatives were fully informed, and to have had the opportunity to fully inform those whom they represented. There might well be circumstances in which that will have required the board to have made its resources available to ensure that that occurred. There might also be cases in which it would have been clear to the board that the representatives did not have a considered mandate from those who they purported to represent, and in such a case we do not think the board would have been justified in simply ignoring that fact. Precisely what it should be expected to have done will necessarily depend on the circumstances of the particular case.

[29] In this case the registrar appears to have been under the impression that the representative board of the fund had had no hand in the decision to allocate surplus and thus that no 'negotiation' at all took place. In that respect we agree with the court below that the registrar was mistaken. We have pointed out that the brochures were distributed and the presentations took place in October 1996. A representative board was appointed the following month, by which time an allocation of surplus had not been made. The allocation was made only during the course of the following year and it took effect in December 1997. There has been no suggestion that the representative board was not fully informed as the matter

[13] Paragraph 38.

progressed. The fact that ‘negotiations’ in the ordinary sense did not take place signifies only that there was nothing upon which the respective representatives disagreed.

[30] There is some suggestion by the registrar that the participating parties were not fully informed of the allocation. Before us counsel for the registrar confined himself to a submission that the participants were never informed of the amount that was to be allocated to the various participants. At the time the proposed scheme was first presented to participants it was not possible to inform them of the amounts to be allocated because that was dependent upon the number of members who elected to transfer to the new scheme. In July 1997 a newsletter was distributed to all participants in which they were advised, amongst other things, of the amount that would be allocated to the employer controlled reserve account upon introduction of the new section. As to the allocation between other participants their representatives were fully aware of what was proposed and raised no objection. But for reasons that we will come to we think that that is in any event not material.

[31] The court below found that the first objection raised by the registrar was unfounded and we agree. It is quite apparent that none of the interested parties themselves showed any interest in engaging in discussion with the board of the fund once they had been informed of the proposals in October 1996, and their representatives on the board were not in disagreement with the allocation once it was proposed to be made. In those circumstances nothing remained to ‘negotiate’ in the ordinary sense of the word.

[32] The second objection by the registrar was that he was not satisfied that the allocation of the surplus had been equitable. His objection was confined to the

failure to allocate any part of the surplus to those members who chose not to transfer to the 'defined contribution' section.[14]

[33] On that issue the approach that was taken by the court below was that the equity or otherwise of the earlier allocation was irrelevant to the question whether the transfer should be approved. It expressed that as follows:

'I respectfully disagree with the first part of the first sentence [in *Coca-Cola*] where it is stated that "the actuarial surplus must be split reasonably and equitably between the relevant stakeholders". In my view the legislator could not have intended to include a requirement of proof that an earlier allocation to the employer had been a reasonable and equitable part of a split. Firstly, the emphasis in section 15F(2) is on the issue that the allocation "was negotiated". The emphasis is therefore on a procedural requirement rather than on the contents or outcome of such a procedure. The last part of subsection (2) refers to the "manner" of such negotiations, which shall be consistent with the principles underlying sections 15B and 15C. By referring to the "manner" of such negotiations, the emphasis is again on exactly this, namely the manner in which the parties negotiated, in other words, the procedure that they followed, rather than on the outcome of such procedure.... [In my view] the legislator intended to only require that a proper procedure involving the members as well had preceded the prior allocation to the employer and that it had not merely been a unilateral decision by the employer- appointed board alone.'[15]

[34] We regret that we cannot agree and, indeed, counsel for the fund offered only faint support for that part of the reasoning of the court below. We think it is clear that the provisions of s 15B as a whole are directed precisely towards ensuring that an allocation of actuarial surplus is reasonable and equitable. Indeed, it provides expressly that if the registrar is not satisfied that a scheme under s 15B is reasonable and equitable he must refer the scheme to a specialist tribunal appointed under s 15K. We think the inference is clear that the tribunal, in making its determination that becomes binding on all the parties,[16] is required to ensure, amongst other things, that the scheme is reasonable and equitable. So

[14] One per cent was allocated to a contingency account but that did not accrue directly to the members.
[15] Paras 76 and 78.
[16] Section 15K(4).

far as the registrar is called upon by s 15F to satisfy himself or herself that the earlier allocation was negotiated in a 'manner consistent with the principles underlying sections 15B and 15C' it seems to us that the construction adopted by the court below is too narrow. The provisions of the legislation as a whole are all directed towards an equitable distribution of actuarial surplus and it would be incongruous if the registrar were required, in effect, to approve the use by an employer of an inequitable allocation that it had received.

[35] But there is an important distinction between assessing the equity of a scheme that is proposed under s 15B, and assessing the equity of an earlier allocation that is sought to be made available for use by an employer under s 15F. The former assessment relates to an actuarial surplus that is available for distribution amongst all participants, including the employer, and that envisages an allocation that must be reasonable and equitable as between all the parties concerned. On the other hand, s 15F is not concerned with allocating an actuarial surplus at all. It is concerned with transferring from one account to another the portion of a surplus that was formerly allocated to the employer. The section requires the registrar to be satisfied only that the allocation that was made to the reserve account was consistent with the principles underlying ss 15B and 15C. It does not require the registrar to be satisfied that the allocation as between other participants was consistent with those principles.

[36] The reason for that is clear. It would be most unfair if an employer who has received no more than its equitable share of the actuarial surplus were to be deprived of that share on account only of the fact that the distribution amongst other participants was not equitable. For if the transfer of the credit to the employer surplus account is not approved (whether wholly or in part) then that part of the credit that is not transferred will be subject to a further allocation amongst all participants under s 15B, yet the portion of the surplus that was allocated to other participants would not be open to revision. There can be no

good reason why an employer should forfeit an equitable allocation that was made to it only because the allocation of the remainder of the surplus was inequitable as between the other participants. The section is concerned with whether the credit in the reserve account should be made available for use by the employer (by transferring it to the employer surplus account) and not with that portion that was allocated to other participants.

[37] With that in mind it seems to us that the equity of the apportionment as between other participants in the scheme is immaterial to the enquiry under s 15F. In this case there is no suggestion that the portion of the surplus that was allocated to the employer (28 per cent of the actuarial surplus) was more than its equitable share.

[38] In those circumstances we think that the registrar was not entitled to refuse the application on the grounds of the alleged inequitable allocation as between the participants other than the employer. That being so in our view the orders of the court below were correct, notwithstanding its misdirection.

[39] The appeal is dismissed with costs.

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R W NUGENT
JUDGE OF APPEAL

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L. V. THERON
ACTING JUDGE OF APPEAL

APPEARANCES:

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