Pension fund surpluses

new legislation

The issue of pension fund surpluses is of great concern to unions and their members. An estimated R80-billion currently exists in pension funds as surplus. At the same time, many current and former fund members have retired to a life of poverty or fear not having financial security on retirement. The purpose of pension funds is to protect members' retirement assets in these members' best interest. Yet, many funds have not consistently lived up to this promise over the last 20 years.

New legislation to address these issues is currently before Parliament. However, it does not recognise members' rights to a fair share of their pension fund. It also fails to rectify the unfair treatment of members in the past or to safeguard funds from similar abuses in the future.

What is surplus?

In a fluctuating economy where investment markets are volatile and the future is unpredictable, 'ordinary surplus' arises in funds in the ordinary course of events.

What is commonly referred to as 'surpluses' that exist in funds are in fact not surpluses in the traditional sense. It represents benefits to which former members were entitled, but did not receive at the time that they left the funds.

Nadine Fourie examines the issue of pension fund surpluses.

Funds transferring members from defined benefit to defined contribution funds without their investment reserves created a big proportion of 'existing surpluses'. (Investment reserves are assets that defined benefit funds originally set aside to provide sound investment of members' retirement assets.) Some retrenched or dismissed members were often denied some of their benefits on exit. These surpluses are defined as 'extraordinary surpluses'.

Labour believes that extraordinary surplus form the bulk of the R80-billion.

To whom does it belong?

Business claims that all surpluses belong to employers, as it represents employers' over-contributions to funds. Hence, employers have been using ordinary and extraordinary surpluses on a massive scale since the late 1980s to, for instance, fund contribution holidays.

Labour demands that all extraordinary surpluses be restored to former members who were denied their proper benefits on exit from funds. Labour believes ordinary surplus belongs to funds and can only be

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used for the benefit of members. Employers contribute to retirement funds as a form of remuneration to employees. Even if it later becomes apparent that the employer contributed at a higher rate than was necessary, the contributions still form part of the fund's assets. There is no basis in law to argue that an employer can claim back assets that were paid in contemplation of a pattern of investment, withdrawals and economic factors, which later proves to be incorrect. If a surplus arises, it remains part of the assets of the fund.

The introduction of new legislation

In June 1998, the government introduced a Pension Funds Amendment Bill, under pressure from employers who wished to see the return of surpluses to employers. The bill was withdrawn after COSATU objected to the lack of protection for members and the easy access the bill gave employers to surpluses. The bill was referred to Nedlac in January 2000 for government, labour and business to seek consensus. This process did not produce an agreement. In August 2001, the bill was referred to Parliament with major disagreements still existing between the role players.

The Portfolio Committee on Finance approved the bill on 21 September 2001. The bill must still be considered by the Select Committee on Finance and will then be tabled in the National Council of Provinces and the National Assembly. (The comments in this article are based on the version of the bill approved by the Portfolio Committee.)

Labour's response

The bill aims to divide surpluses between a fund's stakeholders and introduces a mechanism to resolve disputes about surpluses. The bill also aims to prevent massive surpluses arising in future. Therefore, it has introduced the concept of minimum benefit entitlements for members and pensioners. It also regulates how future ordinary surpluses may be used.

Below, I list the union movement's response to some important provisions.

Apportionment of surplus

The bill requires all funds to submit an apportionment scheme within 18 months of the fund's first statutory valuation after the commencement of the Act. This scheme must set out how the funds will distribute its surplus to members, former members and employers. Labour has objected to the inclusion of employers, as it contradicts the purpose of pension funds and will require trustees to breach the duty entrusted to them (fiduciary duty), which they owe to members alone.

Employer payback

The bill prescribes certain rules and guidelines for apportionment. Firstly, the employer is required to pay back surplus that it has utilised improperly. The bill provides a closed list of what 'improper use' is. It includes using surplus to improve executives' benefits, to 'buy out' the employer's duty to subsidise members' medical aid after retirement and to fund employer contribution holidays between the date of commencement of the Act and apportionment. Notably, past contribution holidays have been excluded from this list.

Because a large proportion of the R80-billion has been spent in this way, this exclusion will reduce employer payback significantly and, thus, reduce the amount of surplus available for distribution.

Of great concern is a last-minute introduction to the bill, rejected by labour

All decisions made in a pension fund affect members and require their input.

at Nedlac. It states that the utilisation of surplus will not be 'improper' if members or their union approved it at the time. In principle, members' approval cannot cure improper schemes devised by the employer. Clear communication does not equal adequate knowledge and appreciation of the rights that may have been waived in the process. In light of the nature of these schemes and all the parties' level of awareness about surplus issues at the time, including the Financial Services Board, it would be unfair to disown members of these assets based on 'approval' at the time.

Prior claims

After employer payback has been determined, members who left funds at any time after 1980 will have a claim against the fund. This will be for the difference between members' benefits on exit and a new minimum benefit, defined in the bill. Equally, pensions will be topped up to a new level of minimum increases, effective from 1980.

This provision improves earlier thinking about surplus apportionment, particularly as business strongly opposed any repayment to former members. However, the impact of this provision is lessened, as former members will not receive what they were entitled to on exit. They will only receive a top-up to a new, artificial minimum. At this stage, the extent of the minimum is still unknown, as regulations to determine how it will be calculated must still be drafted. If the minimum is unfavourable, members' rights could be further eroded.

Negotiating the balance

Only after the claims of former members have been met will members, former members and employers negotiate the distribution of the balance of the surplus

among themselves. The bill does not prescribe how this distribution must unfold, but requires each fund to take into consideration its financial history.

Labour's main concern is that the bill does not prevent extraordinary surplus from being included in the balance of surplus. Hence, it may end up in the hands of employers. In addition, many funds do not have effective member representation, despite the Pension Funds Act requiring it. In these funds, the negotiated process will probably not afford members their fair share of surplus.

The negotiation process also insufficiently protects the interests of former members. One trustee will be appointed to the board to represent the interests of former members, mostly to identify former members and communicate proposals. However, the input of one trustee is unlikely to have a great impact on the negotiations. In these circumstances, the same board that treated transferring members unfairly in the past will now be responsible for the apportionment. It is unlikely that this process will be in former members' best interest or seen to be fair.

Approval of the scheme

Once the negotiations are complete, the board must allow 12 weeks to receive written complaints. Once it has considered these complaints, 75% of the board and the fund's actuary must approve the scheme before submitting it to the registrar of pension funds.

Dispute resolution

If a board requests referral, reaches deadlock or fails to submit its scheme or if the registrar does not regard the apportionment as reasonable and fair, the registrar will refer the matter to an *ad hoc* tribunal. The tribunal will follow a process similar to interest arbitration and determine what it considers a reasonable and fair apportionment.

A serious concern is that the provision contains no individual right of appeal for members, former members or unions if a board refuses their complaints. This undermines the ability of members and former members to exercise their rights under the proposed legislation.

Minimum benefits

All funds will be required to provide minimum benefits on exit from the fund. (In a defined benefit fund, this will be the greater of the member's actuarial reserve value or contributions, plus the employer's contributions and the fund's investment return rate. In a defined contribution fund, members will receive the sum of their contributions, employer contributions and interest.) It is also unclear at this stage what the extent of these future minimum benefits will be. If members' investment reserves, in particular, are excluded from the calculation, this provision may become of little value to members.

One of the most significant concerns about the bill is that it allows for a window period of a year before minimum benefits will become effective. During this period, funds may renegotiate lower benefits than the prescribed minimum benefits. Even funds that can afford the minimum benefits but do not want to introduce them may renegotiate the benefits. Members of such funds will never have the benefit of prescribed minimum benefits. This provision allows funds to contract out of the Act without any recourse for members.

No fund will be allowed to discriminate against members because of the reason for their exit. Members who leave a fund due to retrenchment, resignation, withdrawal, dismissal for incapacity or misconduct,

transfer to another fund or conversion of a fund must all receive nothing less than the new minimum benefit.

This provision is a great improvement on current practices, although it does not prevent the possibility of discrimination in respect of benefits over and above the prescribed minimum.

Funds are also required to adopt a minimum pension increase policy that aims to increase members' pensions in line with inflation at least every three years. Members will be entitled to the lower (and not the greater, as labour proposed) of an inflation-related increase or what is affordable to the fund. By creating an inflation-related ceiling (rather than floor as labour proposed), this provision does not go far enough to protect pensioners' assets against inflation or ensure that members' buying power on retirement is preserved.

Use of surplus

The bill requires funds to allocate future ordinary surplus either in terms of the fund's rules or by taking into account the interests of all the stakeholders in the fund. It contains no other guidelines as to how the surplus must be allocated. However, it states that surplus may be allocated to members and employers.

Once funds have allocated surplus to an employer's or a member's surplus account, the ways in which the surplus may be used are limited. A member's surplus account may only be used to improve members' or former members' benefits, reduce members' contributions or meet expenses due to members. Employer trustees may not vote on the use of member surplus accounts.

Employers' surplus accounts may be used to fund a contribution holiday, pay out benefits instead of post-retirement medical aid, meet expenses due to the employer and transfer surplus between funds in which the employer participates. In addition, the employer may receive this amount in cash to avoid significant retrenchments. This provision includes safeguards to prevent abuse, for example, that 75% of members must give their informed approval of the scheme.

A last-minute introduction in the bill was the provision that member trustees may not vote on the use of employer surplus accounts. This provision is unacceptable in light of the purpose of a pension fund, namely to protect the interest of members. All decisions made in a pension fund affect members and require their input. This is precisely why the Act prescribes the percentage of member representation on a board, while being silent on employer representation.

The impact on unions

Although the bill introduces many improvements to the law governing the industry, key issues in the bill may undermine the very purpose of the legislation. This calls for members and former members to strongly voice their views on these matters before Parliament accepts the bill.

Once the bill is accepted, the union movement will have to do much work. The bill places many responsibilities on unions, including the identification and tracing of former members. The bill also creates areas of activism such as advocating workers' interests during negotiations on surplus apportionment, pursuing complaints on behalf of workers and resisting claims of union 'approval' of employers' improper use of surplus in the past. Unions will have to explore these responsibilities once the bill becomes law. ★

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