ERRORS AND OMISSIONS IN THE DRAFTING OF THE

PENSION FUNDS SECOND AMENDMENT ACT 2001.

A paper to be presented by Rosemary Hunter to the SA Institute of Chartered Accountants

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1. Those of you who were not involved in the protracted negotiations in NEDLAC (the National Economic Development and Labour Council) between labour, business and the government regarding the then proposed legislation to govern pension fund surpluses may have been shocked by the legislation that was approved by Parliament in September last year after four weeks of public hearings. The hearings commenced in August and the draft regulations in which were contained the most contentious and financially onerous provisions which are now in the statute were released a day or so before the public hearings commenced. So unless you were party to the confidential discussions that preceded the hearings, there is no way that you could have been prepared to make representations on the most important provisions of the legislation. Likewise there is no way that you could have made representations on the

1. I am not trying to make excuses for Business South Africa or for the labour movement. I do not know the extent that they was forewarned of the proposed final content of the legislation. It may even be that, had the proposed legislation been published in full, it would have been passed into law without significant changes to its content anyway because it is purpose was so socially desirable. That is in the nature of things. What is clear, though, is that, had the public had the opportunity to comment on the drafting of the legislation, it could have been made much more clear. On the other hand, the more time that people had to comment on the legislation, the more time that they would have had to take pre-emptive steps to avoid the consequences of it. No doubt mindful of this, the legislature passed the statute with a measure of speed and the president signed it into law just as quickly. If the legislation is to be remoulded by the third branch of government, the judiciary, this is going to happen much more slowly which leaves fund with effective dates for the apportionment of surplus soon after its enactment in a position of considerable uncertainty.

2. It is a principle of the rule of law, which is at the heart of our Constitution, that the law should be such that people will be able to be guided by it. For this reason the law must be both clear[1] and prospective in effect[2].

3. The provisions of the Pension Funds Act which are potentially most onerous for employers, namely section 15B(5)(a) read with section 15B(6) are neither and for this reason they are likely to be subject to constitutional challenge. Section 15B(1) requires the board of management of a fund to submit to the registrar of pension funds a scheme for the proposed apportionment of any actuarial surplus in the fund as at the effective date of the statutory actuarial valuation next following the commencement of the Act. The term "actuarial surplus" is defined without reference to the value of amounts -in respect of "past improper use of surplus" by employers. However, section 15B(5)(a) states that -

> "The actuarial surplus to be apportioned shall be increased by the amount of actuarial surplus utilised improperly by the employer prior to the surplus apportionment date as determined in terms of subsection (6)".

4. The first question that arises, then, is that, if the fund does not have any basic actuarial surplus, but the value of the "past improper use of surplus" runs into millions, is the fund required to submit a scheme for the apportionment of surplus ? On the wording as it now stands, the answer is no. Of course, this is not what was intended and so I am informed that it is likely that the Act will be amended to provide that, for the purpose of determining whether there is actuarial surplus as at the effective date in respect of which a scheme for the apportionment of the surplus must be submitted, the value of the "past improper use" must be taken into account. The next difficulty arises when you try to work out for how far back to look for "past improper use of surplus". Is it only as far back as 7 December 2001, is it January 1980, is it 1956, when the Pension Funds Act was first past, or is it the date on which the fund was first established ? The Act is not clear and this strengthens the argument of the employers who will argue in court that the provisions must be found to be effective only from 7 December 2001 despite indications that they were intended to extend further back because it is a principle of statutory interpretation that,

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[1] *National Director of Public Prosecutions v Carolus & others* 2000 (1) *SA* 1127 (SCA) at 1137 – 1138; *Unitrans Passenger (Pty) Limited t/a Greyhound Coach Lines v Chairman, National Transport Commission & others* 1999 (4) *SA* 1 (SCA) at 7 – 8; *Peterson v Cuthbert & Co Ltd* 1945 *AD* 420 at 430.

[2] Matthews *Freedom, State Security and the Rule of Law* (1988) at pp3 – 10, Raz "The Rule of Law and its Virtue" (1977) 93 *Law Quarterly Review* 195 at 196-198. See also judgments of Chaskalson P in *Pharmaceutical Manufacturers of SA: In Re: ex parte President of the Republic of South Africa & others* 2000 (2) *SA* 674 (CC) at para 39 and judgment of Mokgoro J in *President of the Republic v Hugo* 1997 (4) *SA* 1 (CC) at para 102.

unless the contrary is clear, the statute must be presumed to be only prospective in effect. I understand that this matter, too, is likely to be addressed in a battery of amendments to the Act later this year. It will be made clear that the scrutiny of "past improper use" extends back as far as January 1980. This clarity will not, however, defeat the constitutional challenge altogether, however. It is likely that the employers will persist with their argument that these "past improper use" provisions are unconstitutional because –

4.1. As I have already mentioned, the rule of law requires that legislation be both clear and prospective in effect;

4.2. These provisions are retrospective in effect because they effectively impose a civil penalty on employers for conduct that was lawful and reasonable at the time that it occurred.

Simple retrospectivity is not unconstitutional because our Constitution recognises the need to balance competing claims and values. The pressing nature of certain social goals may weigh the balance in favour of retrospectivity[3]. If the matter gets that far, our Constitutional Court will have to weigh the claims of persons who feel that they were effectively cheated of the benefit of money set aside for retirement funding by its use for the benefit of employers against the claims of those employers who will say that the money involved was surplus money that was in the funds only because they had prudently over-contributed to the funds in the past. Employer will say that the financial consequences of a finding in favour of liability for "past improper use of surplus" are potentially so severe that they outweigh the claims of the members and former members of the fund who, our Supreme Court has told us in the well-known *Tek* case[4], were not entitled to anything more than was provided for in the rules of the fund.

5. There is another argument in the arsenal of employers and it is this: While our courts are reluctant to strike down a law on the basis that it is unclear if it is possible to discern its intended meaning[5] if it is not possible to discern the intended meaning of the legislation, it will be struck down. There are many instances of unclarity in the Pension Funds Act. For example, one of the "past improper uses of

[3] Hochman, "The Supreme Court and the Constitutionality of Retroactive Legislation" (73) *Harvard Law Review* at 694-5.

[4] *Tek Provident Fund & another v Lorentz* 1999 4 *SA* 119 (SCA).

[5] *National Coalition for Gay and Lesbian Equality & others v Minister of Justice & others* 1998 (6) *BCLR* 726 (W), *Janse van Rensburg NO v Minister van Handel en Nywerheid* 1999 (2) *BCLR* 204 (T).

surplus" for which employers will be required to pay if they are not allocated sufficient actuarial surplus to cover it is "the cost of benefit improvements for executives in excess of the cost that would have applied had the executive enjoyed the benefits provided to other members"[6]. The term "executives" is not defined so we can only guess at the rank of people in a particular organisation to whom it must have been intended to apply. We also do not know whether the "benefit improvements" exclude the benefits differentiated on rank that were provided for in the original rules of a fund. For example, in a fund to which I previously belonged, benefits did not vest in partners over time as they did in other members of staff; they vested in full immediately on promotion to partnership. If my old firm was still around, would it have been liable to pay the difference between the actual cost of the benefit granted to a partner on exit from the fund and what would have been the cost of the benefit to him or her had he or she not been a partner at the time ? What if the differentiation had not been set out clearly in the rules but was evident from the pattern of conduct on the part of the trustees of the fund when they exercised a general discretion in terms of the rules to grant benefit improvements to individual members ? If the discretion was exercised mostly in favour of executives but sometimes also in favour of non-executives, does this represent a potential liability for the employer ? What if the liability could only be exercised in favour of a member if the employer paid to the fund the additional cost of the enhanced benefit ? On this latter point the FSB has indicated that it intends to seek an amendment to the Act to make it clear that only benefit improvements funded from the fund's existing assets will fall within the ambit of section 15B(6)(i).

6. Another of the forms of "past improper use of surplus" is "the cost of additional pensions or deferred pensions granted to selected members in *lieu* of the employer's obligation to subsidise the medical costs after retirement of those members". I think those of us who have been advising employers how to reduce the liabilities for post-retirement medical aid contribution subsidies will immediately have assumed that this section of the Act refers to those schemes in terms of which employers agreed with trustees that they could grant benefit improvements such as pension increases to those members who agreed to waive their claims against the employers in respect of those subsidies. But that is not what is in fact indicated by the wording. The section refers to the employer's obligation to subsidise the members' medical costs, not the cost of medical insurance and in my opinion they are not the same

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[6] Section 15B(6)(i).

thing. You may think I'm splitting hairs but this interpretation could be upheld by a court. A court is only required to give effect to the intended meaning of legislation if the plain language of the legislation is unclear. Section 15B(6) plainly refers to medical costs and no doubt there are some employers which have in the past subsidised their members' medical costs rather than their medical aid contribution costs. And what does "in lieu of" mean ? Is the "past improper use of surplus" confined to the cost to the fund of benefit improvements granted on active waiver of claims by employees against employers or is it sufficient that the benefit improvements are granted in the context of the simple cessation of the employers' subsidies ?

7. The third form in which "past improper use of surplus" is indicated in the legislation is "the cost to recognise prior pensionable service for selected members or for members transferred into the fund in excess of any amount paid into the fund in respect of such prior service." The employers' outcry concerning the unfairness of penalising employers for approving benefit improvements for black member of the fund in order to remedy the unfairness of their prior exclusion from membership is to be addressed by a specific amendment to the Act to exclude the recognition of prior service for reasons of equity from "past improper use of surplus". But there remain other problems with section 15B(6)(iii). It appears to be intended to target special benefit improvements in the form of the recognition of prior pensionable service granted in *lieu* of salary increases or the use of surplus to equalise benefits for members who transferred into the fund from another fund with poorer benefits on the purchase of a business or the shares of another company by the employer concerned. The prior pensionable service granted in these circumstances arguably was granted in the ultimate interests of the employer but the section is nonetheless arguably arbitrary because it does not target the recognition of deemed future service which has the same effect.

8. The final form of "past improper use of surplus" is the least contentious. It is the value of any contribution holiday enjoyed by the employer after the date on which the Pension Funds Second Amemdment Act came into effect. One problem that has arisen in my practice in relation this section 15(B)(6)(iv), however, has arisen from the definition of "contribution holiday". "Contribution holiday" is defined in relation to a defined contribution fund as -

> "the payment by the employer of less than the difference between the contribution rate recommended by the valuator, taking into account the circumstances of the fund and ignoring any surplus or deficit, and the contribution payable by members."

One of my clients which has 31 December 2001 as the effective date of its statutory apportionment of surplus has asked whether the value of the members' contributions holiday since 7 December 2001 falls within the scope of "past improper use". On the face of it, it does. The contribution payable by the members has been nil. I assume that the valuator has recommended an employer contribution rate on the assumption that members would be required to contribute to the fund at a fixed rate and has the recommended that both members and the employer take a contributions holiday because the fund is considerably over-funded. The actual wording of the definition may, however, require him to revise his recommendation to take into account the fact that the members have not been required to contribute to the fund. I have advised the fund that, as it is reasonably clear that this is not what was intended, there is a good chance that it will not be able to recover the value of the members' contributions holiday from the employer but the contrary is also possible. No doubt the employer has had the indirect benefit

I do not think that employers can be confident of the outcome of this legal challenge.