



RECENT COURT DECISION: REDUCTION OF BENEFITS THROUGH A BACKDATED RULE AMENDMENT

The Supreme Court of Appeal has recently considered the effect of a rule amendment, with a backdated effective date, on payment of benefits. The matter concerned the binding effect of a rule amendment which had the effect of reducing a member's withdrawal benefit from a backdated date, before the amended rule was registered. The court, in this case, overturned a determination made by the Pension Funds Adjudicator.

This case is cause of some concern, especially as it was decided by the Supreme Court of Appeal.

Municipal Employees' Pension Fund ("the Fund") and Another v Pandelani Midas Mudau and Another - Supreme Court of Appeal

THE FACTS

The withdrawal rule

The Fund rules provided that a member who joined the Fund after June 1998 would, upon resignation, be entitled to withdrawal benefits comprising the member's contributions, plus interest, multiplied by three ('the old rule').

The Fund's actuaries noted that due to the combination of lower investment returns than previously enjoyed and the generous withdrawal rule, the rule could lead to the Fund not being able to meet its liabilities.

A backdated effective date

The Fund resolved on 21 June 2013 to amend the old rule, with backdated effect to 1 April 2013.

The amendment to the withdrawal rule provided for a lower benefit of member's contribution, plus interest, multiplied by 1,5 ('the new rule').

The backdating of the rules was an attempt by the Fund to avoid a situation where members may resign as they became aware of the impending reduction of withdrawal benefits.

The Fund applied for the registration of the new rule on 22 July 2013, and the Registrar (as it was then) approved and registered it on 1 April 2014, with the effective date being 1 April 2013.

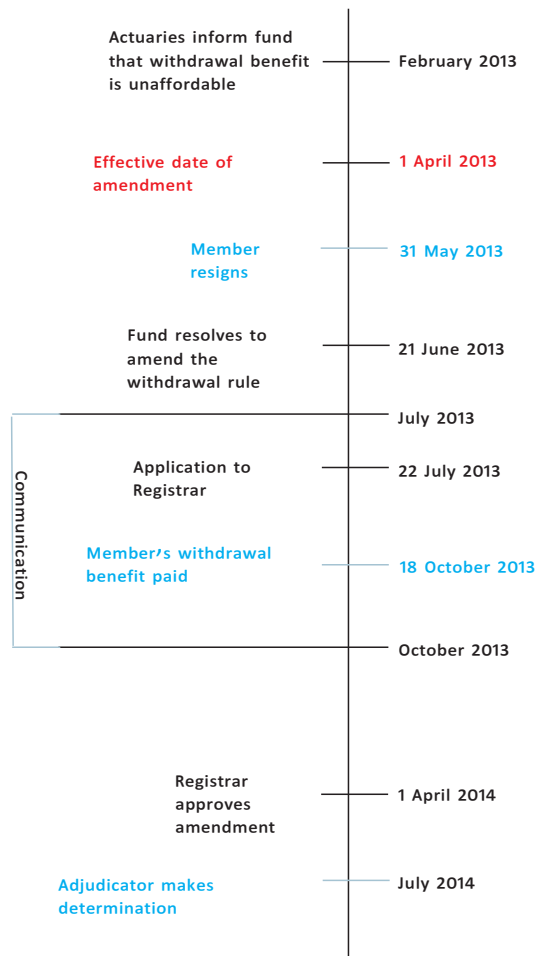
The member resigned before the resolution to amend the rules and after the backdated effective date of the rule amendment.

See timeline of events below.

Benefit paid under the new rule

The withdrawal benefit payment was calculated in accordance with the new rule which was less than the benefit the member would have received under the old rule.

Timeline of events



PENSION FUND ADJUDICATOR DETERMINATION

The member lodged a complaint with the Adjudicator. The Adjudicator effectively ordered the Fund to pay in terms of the old rule.

The Adjudicator's reasoning was:

- the new rule, although applicable with retrospective effect from 1 April 2013, was only approved by the Registrar on 1 April 2014 ("the approval date") and the new rule could not be applied prior to its registration and approval by the Registrar. The Adjudicator relied on the Supreme Court of Appeal case of *Mostert N.O. v Old Mutual Life Assurance Company (South Africa) Ltd*¹; and
- the new rule could not be applied to benefits that accrued before the new rule was approved by the Registrar².

The Adjudicator upheld the complaint.

THE SUPREME COURT OF APPEAL FINDING

The Fund was unhappy with the Adjudicator's determination and made application to court. The matter eventually found its way to the Supreme Court of Appeal ('SCA').

In the SCA, the Fund submitted that:

- the complaint fell outside the scope of the Adjudicator's powers set out in the Act³; and
- the Adjudicator erred as a matter of law in finding that the amended rule could not be applied to withdrawal benefits which accrued before it came into effect on 1 April 2014, despite its retroactive operation.

¹ Mostert NO v Old Mutual Life Assurance Company (South Africa) Ltd (1) (83/2001) [2001] ZASCA 101; [2002] 2 All SA 101 (A) (25 September 2001)

² In support of this finding the Adjudicator relied on National Director of Public Prosecutions v Carolus and others.

³ ss 30H and 30M of the Act, read with the definition of a 'complaint' in s 1 of the Act

THE ADJUDICATOR'S JURISDICTION

Regarding (a) above, the SCA referred to section 1 of the Act where 'a complaint' is defined as one relating to the administration of the fund, the investment of its funds, or the interpretation and application of its rules.

The SCA found that the complaint before the Adjudicator related to the interpretation and application of the Fund rules, and accordingly fell within the scope of the powers vested in her in terms of the Act. The Adjudicator did not purport to rule on the validity of the amended rule (which would have been outside the jurisdiction of the Adjudicator), but rather its interpretation and application to benefits which accrued before its approval.

The backdated effective date

Regarding (b) above, the court was of the view that the amended rules take effect from a date determined by the relevant fund, and if the fund has not determined a date, the rule becomes effective on the date of registration.

In addition, section 12 of the Act⁴ authorises the Fund to amend its rules and to determine the effective application date of the rule. According to the court, a pension fund may adopt a rule reducing a member's pension benefits, provided that is it done in accordance with the fund rules and the applicable statutory regime. If the amended rule explicitly states that it operates retroactively and thus reduces pension benefits due to members with effect from 1 April 2013, then it must be applied in this manner.

The SCA concluded that the amended rule retroactively applied to all withdrawal benefits which had accrued to the Fund's members after 1 April 2013 - the backdated effective date of the new rule.

WORRYING CASE LAW

These findings contradict established case law, such as the Mostert case referred to above. Before the Mudau case, settled law would dictate that a backdated rule amendment could not be applied before the Registrar/ FSCA registered the rule and could not be applied to benefits that had accrued before the rule was registered.

The Mudau case appears to mean that where it is the intention of a fund that the amendment is to be applied from a backdated date (and the rule is clearly worded) that the amended rule may be applied before the Registrar/ FSCA registered the rules and may be applied to benefits that accrued before the rule was registered. This could put members whose benefits have accrued at risk of receiving reduced benefits from a date decided by the board even before the new rule is registered.

Funds may need to consider including wording in such rule amendments which clarifies that the amended rule will not be applied before registration nor to benefits that have accrued prior to registration of the rule.

It is our understanding that Mr Mudau has applied to the Constitutional Court for leave to appeal. The FSCA may ask to be joined if the matter proceeds to the Constitutional Court. The FSCA is currently considering the case and the way forward and has not, as yet, provided any guidance to the industry in relation to rules with back-dated effective dates.

As a result of this case, the FSCA may consider rules with backdated effective dates with more suspicion. Thus, funds may need to consider including wording in such rule amendments which clarifies that the amended rule will not be applied before registration nor to benefits that have accrued prior to registration of the rule, if that is the intention. Funds should consider obtaining expert advice if they are thinking about applying a rule before it is registered, especially where benefits are to be reduced. The very real danger is that the FSCA may refuse to register such a rule. The FSCA is prepared to look at rules on an urgent basis and this may be a more practical solution than a rule with a back-dated effective date.

⁴ section 12 of the Act permits a pension fund to alter or rescind any rule, or make any additional rule, provided that it does not affect any right of a creditor (other than a member or shareholder of the fund), and it has been approved and duly registered by the Registrar. In terms of section 12(4) of the Act, the Registrar 'shall' register the amended rule if he is satisfied that the proposed amendment is not inconsistent with the Act and is financially sound. Note: the current section 12 refers to the 'Authority', being the FSCA, and not the Registrar.