



Legal Services

FINANCIAL SERVICES



## ON THE SCALES 19 OF 2018

### Actuary held personally liable for financial loss suffered by the fund

In the matter of Amplats Group Provident Fund (“the Fund”) and others v Implicated Board Members of the Complainants (“the Former Board Members”), Vivian Cohen (“the Fund Actuary”) and Sanlam Life Insurance (“the Administrator”), the Pension Funds Adjudicator (“the Adjudicator”) has ruled that the Fund Actuary is personally liable to compensate the Fund for its loss in the amount of R40 501 000, plus interest at the rate of 10% per annum calculated from the date of the determination, i.e. 24 July 2018.

#### Summary

- The Fund lodged a complaint alleging that the Former Board Members, the Actuary and the Administrator (collectively “the Respondents”) should be held personally and severally liable for failing to timeously discover a unit pricing error made by the Fund Actuary in respect of the opening balance in the Fund’s Investec Specialist Balanced Portfolio for the period September 2012 to December 2012.
- As a result of the Fund Actuary over-stating the Fund’s unit price, fund credits of exiting members were over-stated by 4%.
- Members who exited the Fund between September 2012 and March 2014 received benefit payments in excess of what they ought to have received.
- Consequently, the Fund suffered a loss of R40 501 000.

- The complaint against the Former Board members was dismissed on the basis that it cannot be expected of a board to replace an expert's opinion with their own and they could not have been expected to notice the calculation error by the Fund Actuary.
- The Complaint against the Administrator was dismissed on the basis that due to the nature of the calculation error, the Administrator would not have been able to detect the error as it could only be detected by an expert advisor.
- By virtue of his own admission of the error relating to hardcoding of the investment data, and based on the expert opinion received by the Adjudicator that the Fund Actuary's conduct fell short of the standard of care expected of an expert actuary, the Fund Actuary was held personally liable to compensate the Fund for the loss of R40 501 000 it suffered.

### **Facts of the case**

The Former Board Members and the Administrator failed to timeously discover a unit pricing error which was made by the Fund Actuary in respect of the opening balance in the Fund's Investec Specialist Balanced portfolio for the period September 2012 to December 2012. The error resulted in Fund's unit price being over-stated which in turn resulted in the exiting member's fund credits being overstated. Consequently, exiting members received benefit payments in excess of what they ought to have received. Therefore, the Fund suffered loss of R40 501 000.

### **The Complainant's argument:**

#### *Against the Former Board Members*

The Fund alleged that the Former Board Members failed to discharge their statutory obligation in terms of the Pension Funds Act ("the Act"), by failing to exercise the required rigorous oversight over the Fund Actuary, a service provider to the Fund. The Fund further alleged that the Former Board Members abdicated their duties in that they failed to adopt reasonable measures to ensure that the error could not happen as well as their failure to detect and rectify the error after it happened. In addition, the Former Board Members failed to ensure that the Fund effected a policy of insurance to indemnify the Fund against losses owing to the dishonesty or fraud of any of its officials or service providers.

Accordingly, the Fund maintains that it suffered the financial loss under the Former Board Member's watch and requested the Adjudicator to hold them personally liable to compensate the Fund for the loss.

### *Against the Fund Actuary*

The Fund submitted that the Fund Actuary erroneously used the same opening balance in the calculation of unit prices in the Investec Specialist Balanced Portfolio between September 2012 and December 2012. As a result, the members' fund credits were overstated. Accordingly, those members who were paid benefits from the date of the error until the error was uncovered were overpaid. The error was only discovered by the Fund's current valuator during the statutory actuarial valuation in respect of the Fund as at 30 June 2014.

The Fund argued that the Fund Actuary should thus be held personally liable for the loss suffered by the Fund as a result of the error.

### *Against the Administrator*

The Fund argued that the Administrator was liable by virtue of the fact that a reasonable administrator exercising the statutory obligations imposed on it would have detected the Fund Actuary's error and would thus have mitigated the loss the Fund suffered.

## **The Respondents' responses**

### *The Former Board Members*

The response submitted on behalf of the Former Board Members was based on the following:

- that the Former Board Members bore no duty to verify the statutory actuary's unit price in the ordinary course;
- that in the absence of an obvious error, it was eminently reasonable for them to rely on the calculations provided to them by the Fund Actuary;
- that it took more than a year for the current statutory actuaries, Momentum, to determine with certainty that there was a calculation error, only after being alerted to it by the Administrator;
- that the error committed by the Fund Actuary was not an error which would have been apparent to the Former Board Members;
- that the Fund's systems of delegation and control over service providers, including the Fund Actuary, were sufficient and reasonable and did not fail or give rise to the calculation error;
- that it was improper for the Fund to pursue the Former Board Members on the basis of personal liability on wholly insufficient information and vague and unspecified allegations;
- that they complied with their duty to seek expert advice where they lacked sufficient experience and were in any event required by section 9A of the Act to appoint the Fund Actuary;

- that the Former Board Members were required to rely on the recommendations of the Fund Actuary, unless they have a proper basis on which to reject it;
- that should they not accept the Fund Actuary's recommendations, they would have needed to appoint a second expert actuary to make the necessary investigations and calculations on their behalf;
- that it could not be expected of a board to replace an expert opinion with their own and specifically not the opinion of the Fund Actuary;
- that to require the Former Board Members to verify the Fund Actuary's working papers and calculations would constitute an unreasonable and unduly onerous level of micro management;
- that on the information served before them, there was nothing unusual that should have alerted them that a verification of the Fund Actuary's calculation was required; and
- that no members suffered any financial loss as a result of the calculation error as the loss was fully funded from the Fund's reserve account in line with Momentum's recommendations.

The Former Board Members requested the Adjudicator to dismiss the complaint against them with costs on the 'attorney-client scale,'<sup>1</sup> with such costs having to include the costs consequent upon the employment of two counsels.

#### *The Fund Actuary*

The Fund Actuary admitted that an error was made in the calculation spreadsheet that was used to determine the unit price of the Fund. He confirmed that the error was essentially in the calculation of the investment returns of one of a large number of investment portfolios, which were then combined in order to determine the weighted average return and the unit price. Nevertheless, he argued that although an error was made, it was not due to any negligence on his part. He stated that the unit price were outsourced by him and carried out by a third party.

The Fund Actuary further argued that the actuarial error was that a cell on the spreadsheet on one of the investment portfolios was inadvertently hard-coded as the value as at 31 July 2012, whilst it should have referred back to the value from the previous month's balance by means of a standard excel formula. He admitted that as a result of this error, the unit prices were overstated and the overall result, being a weighted average investment return, still appeared reasonable to him when he did an overview of the calculations.

He further submitted that although he is aware that the members were overpaid as a result of the unit price error, the Fund was able to comfortably absorb the financial impact of the error without any of the

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<sup>1</sup> Attorney and client costs means the costs which an attorney is entitled to recover from his client for the disbursements made by him on behalf of his client and the professional services rendered by him or her.

remaining members being adversely affected. In particular, the overpayment had been absorbed by the processing error reserve account, even though this account has been significantly reduced as a result.

### *The Administrator*

The Administrator submitted that the administration agreement it concluded with the Fund did not contain a term placing an obligation on it to reconcile the Fund's assets and liabilities, whether on a daily basis or at all. It further argued that its duty to observe the utmost good faith and exercise proper care and diligence only extends to obligations set out in the administration agreement it had with the Fund.

Ultimately, the Administrator argued that it could not be held liable for failure to detect the calculation error as it had no obligation to do so.

### **The Adjudicator's determination**

The issue to be determined was whether the Respondents were personally and severally liable for a unit price calculation error by the Fund's Actuary which resulted in the Fund's unit price being overstated and the members' fund credit being overstated by 4%.

### *The Former Board Members*

The Adjudicator reiterated the argument advanced by the Former Board Members that they had no duty to request, review, investigate or recalculate the Fund Actuary's monthly unit price calculations at any point in time. Therefore, the Former Board Members acted with the required due care and diligence. The Adjudicator further held that it cannot be expected of a board to replace an expert's opinion with their own and specifically not the opinion of the Fund Actuary whose appointment is a statutory requirement. Accordingly, she ruled that the Former Board Members could not be held liable personally and severally for the Fund Actuary's conduct.

### *The Actuary*

The Adjudicator held that the actuary was negligent if a reasonable person in his position would have acted differently and if the unlawful causing of damage was reasonably foreseeable and preventable. In the case of an expert such as the Fund Actuary, the test for negligence in regard to the exercise of the expert activity is the test of the so-called reasonable expert.

The Adjudicator enlisted the services of an independent actuary to assess whether the Actuary acted reasonably or not. According to the independent actuary, the implication of hardcoding is the risk of

typographical error or errors in what is inserted. The implication of erroneous hardcoding damages the integrity of the process leading to further implications that members are not accruing the benefits they are entitled to and the consequential effect on the financial soundness of the Fund. He further argued that it would have been obvious to any actuary checking or reviewing that the investment returns on the large number of other portfolios looked unusual. The independent actuary concluded that the conduct of the Fund Actuary as an expert advisor does not appear to have been reasonable.

The Adjudicator ruled that the Fund Actuary, as an expert advisor, was negligent and should be held liable for the loss suffered by the Fund. Accordingly, she ordered the Fund Actuary to compensate the Fund for its loss in the amount of R40 501 000.

#### *The Administrator*

The Adjudicator ruled that the Administrator cannot be held liable as it is the responsibility of the board, the Principal Officer and the valuator of the Fund as well as the auditors, consultants and risk consultants to consider the quarterly report provided to the Fund showing the mismatches at the end of each month and verify the correctness of the values in those reports and to take appropriate action.

*Comment: PF Notice 1 of 2016 introduced a requirement that a valuator appointed by a fund must be a natural person. In addition, such valuator must maintain in force suitable professional indemnity insurance with regard to the fund for which he or she is appointed.*

*This case serves as a reminder that valuers are appointed independent of the actuarial or consulting firms with which they are employed. In the event of any wrongdoing, the valuator can be held personally liable. In addition, it is important that where a valuator works independently, he or she gets adequate insurance cover to protect himself or herself from having to personally compensate the fund for any financial loss.*

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***If you need more information, please contact your consultant.***

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