

IBM SA PFAG Newsletter No 19, February 2004

Dear Pensioner,

This newsletter deals with several important issues and events which have taken place over the last 3 months: the Pensioner Protest in November, the letter to the Chairman of IBM, IBM's reactions, and our plans for court action.

This newsletter has been produced by the whole committee, after much deliberation. Richard de Oude became PFAG Chairman after the resignation of Eric Glover (due to work pressure) late last year.

The Protest.

Pensioners in Johannesburg, Cape Town and PE conducted protests against IBM's interference with the governance of the Fund and its use of fund assets for its own benefit. The object was to publicise several major issues of mal-governance by IBM. These were IBM's denial of adequate pension increases to pensioners, failure to make contributions to the fund, use of fund assets to fund their retrenchment programmes, improper accounting of pension fund assets earmarked for employees who opted to transfer to the provident fund and IBM's appointed trustees changing of the fund's Rules to keep control of the fund. The protest event attracted substantial media attention including a front-page story in the Business Day, the STAR, Die Burger, Cape Times, ITWEB, SA Computing and several TV and radio coverages. A key part of the protest was the delivery of a letter to S Palmisano, Chairman of the IBM Corporation. A copy is included in this newsletter.

IBM's reaction to the Protest Petition.

You will have received the letter from Dudu Nyamane, IBM SA's H R Director, together with the attached letter from Mark Harris, Country G M, stating his response to the letter of complaint by the PFAG to the Chairman of the IBM Corporation. The intention was to give the impression that all is well with the Pension Fund and that the Elected Trustee issues and PFAG concerns are "much ado about nothing". The implication is that the PFAG are misguided in our endeavours.

What IBM says about the financial standing of the Fund and the effectiveness of the day-to-day operations (paying pensions every month and maintaining administration of contributions and accounts by the board of Trustees) is true. You would expect nothing less from a responsible Board of Trustees. The Fund's assets are as high as ever they have been. The surplus is substantial and we are about to embark on an exercise, according to the Act amendments of 2001 to apportion this to the members, former members and the employer.

What IBM does so well, through skilfully drafted communication, selective use of legally filtered facts, and the assumption of absolute rectitude in all its dealings with the Pension Fund, is to cast themselves as the aggrieved party who would never do wrong. Of course, they must deny all allegations of past illegality or impropriety. It is a legal necessity for them to do so. What this does is to cleverly mask the issues that lie behind this apparently wholesome façade.

It is not intended to do a point by point refutation of the positions stated by IBM in their letters. Rather, we would hope to explain to you, in simple and concise terms, what problems the Elected Trustees face and what we seek for pensioners and the Fund as a whole. For many of you who have followed the issues of this fund since 1998, there is nothing new here and we apologise for any

repetition; but we wish to clearly summarise the key problem areas.

IBM, in formal communications with the Financial Services Board (FSB), has stated that Elected Trustees are "greedy and self-serving in their pursuit of benefits for themselves and the pensioners". In their view, this is why we seek resolution on issues relating to use of surplus to fund Early Retirement Offers, or question non-payment of Company contributions to the Fund, or wrestle with the nature of the Transfers between the Pension and Provident Funds. In their view, we want all the money. They omit to acknowledge that they also want all the money.

Before 1999 IBM, in practice, treated the Fund as an extension of its Finance function. They still see it that way today. Appointed trustees have openly stated that they will resist any changes that may weaken IBM's control of the Fund. But any Fund can only act in terms of its Rules, the Pension Funds Act, and the various Regulations that give substance to the broad principles embodied in the legislation. FSB procedures are in place to foster compliance and good governance. This becomes the point of departure for any company seeking to further its own interests while appearing to meet the letter - if not the spirit - of the requirements. It is not what is done, but how it is done that becomes important.

We believe that we have been eminently reasonable in all our dealings with IBM. Evidence of this abounds. IBM has never reciprocated. They understand, as well as we do, that we persist with the issues because that is the only lever we have to gain any concessions from them. Without issues, they could simply ignore us.

Any Fund action can only be taken if it is agreed to by the Board of Trustees. However, just prior to the election of member trustees, IBM's appointed trustees changed the Rules to restrict any effective voting procedure and block any deadlock-breaking mechanism. Anything objectionable to IBM is stopped at Board level through block voting by Appointed Trustees. Beyond that, IBM also embedded in the Rules a right of veto in every area of consequence to the Fund: finances, benefits, Rule changes etc. Nothing happens unless IBM says it can. Trustees are powerless.

Some brief comment on the major issues:

Low Pension Increases. In 1996 IBM decided on a policy to limit pension increases in order to grow the surplus and then utilise it for its own benefit. Between 1996 and 2001 increases averaged 4.5% pa as against an inflation rate of 6.5% and an average ROI of 16%. In 1998 the Board agreed to a CPI increase of 6%. IBM vetoed it and we got zero. If our pensions had been maintained at the level of comparable companies in our industry we would be up to 50% better off.

ERO Waiver Claims. Use of surplus to fund the waiver of early retirement penalties occurred on several occasions from 1991 onwards. However, the major occasion occurred in 1994. While there is evidence that the Company considered using the surplus this way, there is no evidence that the matter ever came before the Board of Trustees. No Rule existed at that time to permit this. If the Trustees did approve the matter, then they appear to have acted beyond their powers. In the Fund files no Minutes of Meeting exist, no Agenda, no Board pack for discussion. Coincidentally, the same documents are missing from the Administrator's files. Shortly thereafter the Trustees did create a Rule to allow for this, but only if the Company agreed to pay the cost of the waivers. After all, headcount reduction benefits the

Company, not the Fund. IBM has since secured a legal opinion, using an unlikely Rule, suggesting that Trustees did have the powers to act, even though they may not have known it. If the “unlikely” Rule is valid, this begs the question of why trustees then created a Rule to permit waivers.

Transfers: The money that should have gone across from the Pension Fund to the Provident Fund did go across. However, the timing of the various sums moved across, who it went to, what monies represented transfer of investment reserves or waiver of early retirement penalties, and how consistently this was done in terms of FSB procedures are where the issues arise. Meeting Minutes are inadequate. The Transfer application certificates from the FSB are missing. They are not in the Fund’s files, the Administrator’s files, or the FSB files. Yet more coincidence.

Contributions: IBM has not contributed since its return in 1996. However, the Fund consists mostly of pensioners with very few Active (still working) members. These members still contribute.. The issue is that the Rules as we understand them require the Trustees, after consulting the Actuary, to approve a contribution holiday. IBM argues that as long as the Actuary says that there are sufficient funds, they can skip contributions and have continued to do it. Unfortunately, this view was supported by industry practice, incorrectly, until stopped by the recent changes to the Pension Funds Act.

Deferred Pensioners: This most badly treated group of once-deferred pensioners have had their plight remedied by the amended Act, some with a ten fold increase in their pensions. Years of lobbying on their behalf by us achieved nothing. Reason? It would use up surplus.

What do we want for you and for the Fund?

- A suitable Pension Increase Policy. A policy that will preserve the purchasing power of pensions. A policy based on investment performance and affordability and which compares favourably to those funds in our industry in SA. A policy that, given past performance, will permit increases of CPI or better. IBM is offering 2/3rds CPI for two years with a Catch up increase to CPI every third year. This means a perpetuation of losing income relative to the increase in CPI.
- A strong Notional Pensioner Account (NPA) structure. The NPA represents the assets backing the pensioner liabilities (current and future pension payments). We want appropriate investment and contingency reserves built in to protect us from market volatility.
- A Matched Investment Strategy with safe investments that will reduce the risk to the Fund (and IBM) while providing the needed investment returns for the Pension Increase Policy.
- ERO penalty waiver re-imburement to the fund. Our Rules from May 1995 onwards state that trustees may grant penalty waivers for early retirement *provided IBM re-imburses the fund*
- ERO Waiver Equity. Most pensioners received the benefit of a waived penalty. But not all. Some pensioners are receiving up to 30% less pension as a result. This decision was IBM’s.
- Arrears Payment. For six years pensioners received increases of 2/3rds of CPI, this despite repeated approvals by the Trustees but vetoed by IBM. By our estimation this amounts to about six months of lost pension income over the period. It has resulted in financial hardship for many pensioners. We believe a lump sum payment – ahead of surplus distribution – to be the right thing to do.
- An autonomous Board of Trustees with an independent Chairman, effective voting and deadlock-breaking mechanisms, and NO (or at worst a qualified) IBM veto.

- Rule Changes that reflect the above changes, embody the intentions of the amended Pension Funds Act, and are prescriptive wherever possible.

Plans for Court Action

Through the Elected Trustees we have expressed our concerned views sincerely and logically to the Board and to the Company for 6 years. Advice, both professional and legal has told us we are correct in our attempts to gain fairness and justice from IBM. Not only have they resisted our suggestions over the years, they have actively sought to discredit our cause, and have never given any serious indication of a willingness to negotiate a solution. Much of what we are trying to achieve may be resolved with the forthcoming regulations and legislation, but this is still not known and the outcomes are uncertain. Most of our issues are basic governance matters and would normally have been addressed by the Act of 1996. We have no recourse but to seek legal advice with the aim of getting assistance from the High Court. We are in the process of obtaining this advice right now. This will cost us money and we ask you to study the next section on Fundraising.

Fundraising

At the AGM in August last year a proposal was put forward by the committee to request all pension fund members who could afford to, to contribute towards a fund to pay for legal action against IBM. Many of you sent cheques to us which have been deposited in the PFAG bank account and many of you pledged money to be paid in when we were in a position to use it. A suggested guideline was that of contributing *half of one month’s pension* to the cause. Many of you have done just that, some have put in more, whilst others have put in modest amounts which reflect their ability to contribute. We want to thank all of you for your contribution.

We have done some homework based on legal advice and the following is a possible scenario, divided into 4 steps:

1	Legal advice on which of the issues to take to court	R40 000
2	Legal preparation of High Court Action on, say, 3 issues	R 60 000
3	Advocate fees	R 150 000
4	Court litigation	R 190 000

Each step will be carefully considered and funds will not be used for any subsequent step without advising you fully first. The costs may vary from those shown above depending on the state of play.

Thus, an investment of R440 000 can be made as above and may give us the results we want. The recovery from the respondent (IBM) could be between R20million and R200million plus costs. If the court awards us the costs much of what you contribute may be refunded to you.

One of the possible items we are suing for is the matter of the CPI pension increases granted by the Board of trustees in June 1998. This decision was blocked by IBM and, if you remember, we received *no increase* that year. The CPI increase in 2001 brought the level of pension to CPI, but no compensation was made for the money not paid in 1998 to 2001, which, with interest is today worth R12 million. If paid out to every pensioner this equates to about 6 months of pension for each of us and would be paid out in a lump sum. The Board sought legal advice from attorney Bortz of Werksmans and Advocate Gauntlet SC and they confirmed that IBM had no authority to block the implementation of the trustees’ decision. IBM continues to oppose the correction of their illegal action to members. If we succeed, your investment in your future will be significantly improved.

It is quite clear to us, after 5 years of attempts by your elected trustees to rectify these issues that IBM is not prepared to debate or negotiate any of the mal-administration or mal-governance issues we have raised. It appears the only authority they will listen to is a ruling from a High Court judge forcing them to pay up. Should IBM offer to settle out of court we will give it careful consideration provided we are satisfied that all the members of the fund get a fair deal.

We are at the same time working with the FSB, and we are having discussions with them on other key issues which relate to the ongoing actions of IBM and the Company-appointed trustees who continue to act against the interests of the members in contravention of their statutory duties to protect the interests of the members. The FSB and the High Court may decide to appoint a curator to manage the fund or to liquidate the fund.

You will have been informed by the new Medical Aid Action Group that IBM is also attempting to reduce medical benefits and phase out its financial commitments to the Medical Aid fund, that the Group is seeking legal advice with the intention of also going to court. But while there are only 320 pensioners in the pension fund, there are 1,600 members in the medical aid, which includes retirees from the Provident Fund and current employees. This has a much wider impact.

Whichever route we take, and however far we go, funds will have to be raised. I know it's tough for some of you right now, but we believe our drive to get compensation will be successful. I therefore request of each of you to contribute what you can. If

you are unable to send money, or want to wait until later, or until developments are clearer for you, you may submit a *pledge* to us which says you would like to contribute a certain amount, but later. This will allow us to see the full potential of our income for legal costs.

There are 2 methods of payment:

1. Send a crossed cheque made out to "IBM Pension Fund Action Group" posted to PFAG, Box 1264 Ferndale, 2160, or
2. Deposit into the PFAG bank account ABSA Account No. 40 5073 4334. The Branch is in Randburg but with ABSA you do not need to state this.
3. Your contribution will be acknowledged, and remember, if we succeed, refunds will be made as permitting.

Please do not hesitate to phone me, or any other member of the PFAG Committee, if you have any questions or concerns.

Richard de Oude
PFAG Chairman. (011) 673-0271, 083 273-9559

The Petition to IBM on Nov 13, 2003

The following is the text, reproduced here in two columns to save space (and therefore postage). As discussed above, IBM responded at the lowest possible level and refuted all our allegations.

IBM PENSION FUND ACTION GROUP

P O Box 1264
Ferndale
2160
South Africa

13 November, 2003

Mr Samuel J. Palmisano,
THE PRESIDENT, IBM CORPORATION
New Orchard Road,
ARMONK, NEW YORK 10504.

Petition by the Pension Fund Action Group: IBM South Africa Pension Fund

As Acting Chairman of the Pension Fund Action Group I have been directed to present to you, through the Managing Director of IBM South Africa, on behalf of the Pensioners and Members of the IBM South Africa Pension Fund, our concerns about the management of our Pension Fund. We are appealing to you to investigate our complaints and to respond favourably to our request for a "FAIR DEAL".

These concerns were previously brought to the attention of the Corporation, and I refer to the visit of Mr M Jack to South Africa in 1999, who promised to investigate our complaints and report back. This never happened. In 1999 Mr Roger Hull, an elected Trustee of the Fund, also brought some of these issues to the attention of Mr Phil Webber the Vice President, Employee Benefits, but no corrective action was taken.

The actions outlined below were taken by the Directors of IBM South Africa, and during the period that IBM Corporation had divested from South Africa, by the Directors of ISM and later ISG Ltd. Subsequent actions after 1996 were taken by the Company Appointed Trustees of the Fund or motivated by Senior Executives of the IBM Corporation, including the Director of the IBM Retirement Funds for Europe and his staff.

In terms of South African law, the Pension Funds Act and other South African legislation regulates Pension Funds. The assets of the fund belong to the Fund as a separate legal entity and do not belong to the Employer Company or the IBM Corporation. These Funds are required to be managed by a Board of Trustees which

has statutory fiduciary duties to protect the interests of the members at all times, as well as other Fiduciary duties established by the Pension Funds Act and other relevant legislation.

From the inception of the Fund in 1970 until 1987 when the IBM Corporation disinvested from South Africa, the Board of Trustees managed the Fund in accordance with the Pension Funds Act.

However in 1990/91, the Company (then called ISM) carried out a Retrenchment program, which was partly funded by the Pension Fund, contrary to the Rules of the Fund and the Pension Funds Act. The cost to the Fund was R2.5 Million.

Similar action was taken by the Employer Company in 1994/1995, during which years the IBM Corporation was in the process of re investing in South Africa and acquiring a shareholding in the employer Company. At that time a proposal was made to the employees of the Company to offer a transfer by the "active" members to a Defined Contribution Fund—the ISM Provident Fund. Once again the Employer Company made an Early Retirement Offer to "in service members" of the Pension Fund to transfer to a newly established Defined Contribution Fund—the ISM Provident Fund. Application was made to the Registrar of Pensions for the transfer of 1214 members to the new Fund, and an amount of R377 million was approved to be transferred to the ISM Provident Fund and to the ISM Fixed contribution Fund, for the credit of individual members accounts and to a Members Reserve, in the ISM Provident Fund and to the ISM Fixed Contribution Pension Fund.

However before that transfer took place ISM made a further Early Retirement Offer to members over 55 years of age to transfer to the Defined Contribution Fund and then resign from the Company immediately. If they accepted that offer they would receive their full actuarial values in cash, enhanced to include the value of a pension from the Pension Fund and further enhanced by the waiver by the Employer Company of the early retirement penalty provided in the Rules of the Pension fund. This proposal was contrary to the Rules of the Fund, but was carried out by the Employer Company (ISM). The cost to the Pension Fund was R 25 Million.

Since these approximately 100 members effectively exited from the Pension Fund with enhanced benefits, their "share" of the Investment reserve in the Pension Fund that had been approved by the Registrar of Pensions to be transferred to the Members Reserve, was not paid over to the ISM Provident Fund. Subsequently a special "Restructure Proposal" prepared for the IBM Corporation by the Actuary and Administrator of the Fund, to examine ways and means for the IBM Corporation and the Employer Company to gain access to the surplus in the Pension Fund. Mr H Rodd, the Administrator proposed that since the Funds related to those members who had accepted the Early Retirement Offer and had effectively exited from the Pension Fund, the amount of R27.8 Million, which had not been paid to the Members Reserve in the ISM Provident Fund, be transferred to an Employer Reserve in the ISM Provident Fund for the exclusive benefit of the Employer (ISM). ISM could then use these funds to meet its future contributions to the ISM Provident Fund. This, he claimed, would effectively be a "legitimate means of accessing the surplus" and the cost saving to ISM would benefit the IBM Corporation by an increase in the profit of ISM, which had been acquired by the IBM Corporation. This action was in our opinion illegal, and represented a serious contravention of the Pension Funds Act and other relevant legislation in SA. The Trustees accepted Mr Rodd's advice and the transfers were in fact carried out. The cost to the Pension Fund was R27.8 Million plus interest to date at the average rate earned by the Pension Fund.

During the period 1994 to 1998 the Actuary and Administrator carried out other irregular actions, with the knowledge and support of the Board of Trustees, which were for the financial benefit of IBM who ultimately acquired full control of ISM and its Holding Listed Company ISG. It has been established by an independent investigation and audit by Ernst and Young, that in the years 1994 and 1995 amounts in excess of R45 million was transferred from our Pension Fund to the credit of an "Employers Reserve" in the ISM Provident Fund, for the exclusive benefit of the Employer Company. We have not been able to find any approval from either the Board of Trustees of the Registrar of Pension Funds for the transfer of these funds.

One of these actions was the delay in the implementation of new legislation in South Africa in 1996, which required the restructure of Boards of Trustees of Pension Funds to include an equal number of Trustees elected by members. After the Pension Fund Action Group wrote to the Board of Trustees of the Fund, they committed in June 1998 to implement the mandatory restructure of the Board. The Board of Trustees did in fact pass a resolution restructuring the Board to comprise three Appointed Trustees and three Elected Trustees with an Independent Chairman. The Board of Trustees also approved a full CPI pension increase.

This action would have created a proper working relationship between the Pension Fund Action Group and IBM South Africa. These positive actions were also communicated to the Inspector of the Financial Services Board who was investigating the complaints of the Members and the Pension Fund Action Group. However, the resolutions of the Board of Trustees were in fact "vetoed" by a representative of the IBM Corporation. No restructure took place and the Rules were not amended, as required by law, and no pension increase was granted in 1998.

A high-level IBM assignee from IBM Germany was appointed by the IBM Corporation as Chairman of the Board of Trustees. This set in motion a process of confrontation between the Company Appointed Trustees and the Member Elected Trustees, which continues to the present time. The election of trustees was delayed until the last possible time and even after they were elected, they were excluded from a meeting which illegally changed the Rules of the Fund to increase the power of the IBM Corporation to effectively control the Fund. In the period 1999 to 2001 the executives of the IBM Corporation continued to veto affordable increases approved by the Board of Trustees, until new Pension Fund Legislation stopped this process. Regrettably the conflict of interests continues to make the Fund "ungovernable" as important proposals which are for the benefit of the pensioners (who now comprise 95% of the Fund), and which would result in Good Governance of the Fund, are consistently blocked by the Company Appointed Trustees, all of whom are Senior Executives, who act consistently against the interests of the pensioners of the Fund. Important new amendments to the Pension Funds Act have not been complied with.

There are approximately 350 pensioners, 100 deferred pensioners and a large number of former members who are entitled in terms of the new legislation to receive their "minimum benefits" from the Fund. Many of the pensioners have long and loyal service to IBM and its customers (some as long as 36 years). IBM by its actions has and still is depriving these former loyal employees of IBM and their families of their rightful benefits from the funds invested for them in the Pension Fund.

It is not too late to remedy the situation and correct the inequities of the past. We appeal to you to review the issues and respond positively to our requests for a "fair deal".

As employees who loyally served the Company for many years we do not seek confrontation with the Corporation. We want to believe that IBM has not abandoned the basic principle of "Respect for the Individual" which was a cornerstone of IBM's standards, and look forward to your prompt response.

We therefore ask the following should be done:

1. IBM must contribute to the Pension Fund according to its obligations in terms of the Pension Funds Act.
2. The Board of Trustees, to maintain the purchasing power of pensions, must grant annual pension increases that are affordable in terms of the returns on the Pension Fund assets.
3. Pensions must compare favourably to other leading funds.
4. Past inequities must be corrected, including the return by IBM of Pension Fund assets used to finance Retrenchment Packages, which were not equally given to all retirees.
5. IBM must work together with the Trustees to achieve good governance of the fund, in particular in bringing the rules in line with the intentions of the Pension Funds Act.

Thank you.

Yours faithfully,

A. Richard de Oude,
Acting Chairman
IBM South Africa Pension Fund Action Group