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## **LEGAL UPDATE FAW 2/2009: BENEFICIARY FUNDS**

The Financial Services Laws General Amendment Act No. 22 of 2008 was promulgated in Government Gazette No. 31471 on 30 September 2008 and the relevant provisions came into effect on 1 November 2008. This Act amongst others introduced beneficiary funds, which changed the method of payment of death benefits and removed the trustees' discretion to pay these benefits to trusts.

### **The position before 1 November 2008**

Section 37C of the Pension Funds Act No. 24 of 1956 deals with the disposition of pension benefits upon the death of a member. At the outset, the section (37C) expressly provides that a benefit payable by a fund upon the death of a member shall **not** form part of the assets in the estate of such a member, but shall be dealt with in a specific manner.

Until 1 November 2008 subsection (2) of section 37C stipulated that payment by a fund to a trustee contemplated in the Trust Property Control Act No. 57 of 1988 for the benefit of a dependant or nominee shall be deemed to be a payment to such dependant or nominee. The effect of this provision was that trustees could at their discretion pay death benefits to a trust.

As it stood then, section 37C effectively made provision for a death benefit to be paid in one of four manners:

1. Payment directly to the dependant or nominee (normally only where the dependant or nominee is a major).
2. Payment to a guardian (usually on behalf of a minor dependant or nominee).
3. Payment to a trust (in terms of subsection (2), as discussed above).
4. Payment in more than one payment (instalments) provided that in respect of a major dependant or nominee, this method of payment could only be used if the major agreed in writing.

### **The position from 1 November 2008**

In relation to the disposition of death benefits, the Financial Services Laws General Amendment amended subsection (2) of section 37C of the Pension Funds Act to now provide that payment by a fund for the benefit of a dependant or nominee shall be deemed to be a payment to such dependant or nominee, if payment is made to –

- “(i) a trustee contemplated in the Trust Property Control Act, 1988, nominated by –
- (aa) the member;
  - (bb) a major dependant or nominee, subject to subparagraph (cc); or
  - (cc) a person recognized in law or appointed by a Court as the person responsible for managing the affairs or meeting the daily care needs of a minor dependant or nominee, or a major dependant or nominee not able to manage his or her affairs or meet his or her daily care needs;

- (ii) a person recognised in law or appointed by a Court as the person responsible for managing the affairs or meeting the daily care needs of a dependant or nominee; or
- (iii) a beneficiary fund.”

Accordingly, with effect from 1 November 2008, section 37C now provides for a death benefit to be paid in one of the following manners:

1. Payment directly to the dependant or nominee (normally only where the dependant or nominee is a major).
2. Payment to a trust nominated by –
  - (i) the member, prior to his death,
  - (ii) a major beneficiary, or
  - (iii) a guardian or a caregiver.
3. Payment to a guardian or caregiver (usually on behalf of a minor dependant or nominee).
4. Payment to a beneficiary fund.
5. Payment in more than one payment (instalments), provided that in respect of a major dependant or nominee, this method of payment could only be used if the major agreed in writing.

Since no payment may be made to a trust nominated by the trustees with effect from 1 November 2008, it follows that trustee resolutions from that date providing for such payment to a trust can't be executed. Where an administrator is provided with such a resolution, it is suggested that this be referred back to the trustees, who can then resolve to have the benefit concerned paid into a beneficiary fund. The administrator cannot unilaterally substitute the reference to a trust nominated by the trustees with a beneficiary fund in these cases. In other words, administrators cannot assume that payments to a trust can be read as payment to a beneficiary fund. Momentum requires an expressly clear instruction and authority to pay benefits to any entity.

### **Beneficiary funds**

The Financial Services Laws General Amendment Act defines a beneficiary fund as *a fund referred to in paragraph (c) of the definition of 'pension fund organisation'*, thereby bestowing upon it the status of a fund, with its own board of trustees, principal officer, etc.

Paragraph (c) of the definition of 'pension fund organisation' refers to *any association or persons or business carried on under a scheme or arrangement established with the object of receiving, administering, investing and paying benefits, referred to in section 37C on behalf of beneficiaries, payable on the death of more than one member of one or more pension funds*. It therefore only deals with death benefits and accordingly only death benefits payable by a retirement fund may be paid into a beneficiary fund; death benefits payable in terms of a freestanding insurance policy cannot be paid into a beneficiary fund. These benefits in any event do not fall under the provisions of section 37C.

Where a death benefit allocated to a minor beneficiary is transferred to a beneficiary fund, that minor becomes the member of the beneficiary fund. Upon the death of the member any remaining balance of such benefit will be paid into the member's estate, or, if no inventory

in respect of the beneficiary has been received by the Master of the High Court, into the Guardian's Fund.

Not all the provisions of the Pension Funds Act applying to retirement funds are applicable to beneficiary funds. For one, the provisions of section 28 regarding the termination of a fund do not apply to beneficiary funds. The Registrar may prescribe matters that must be provided for in the rules of a beneficiary fund regarding voluntary termination and the transfer of the remaining assets in that instance.

The Financial Services Laws General Amendment Act amended section 37C to specifically state in subsection (2)(b) that no payments may be made *on or after* 1 January 2009 to a beneficiary fund which is not registered in terms of the Pension Funds Act. Section 37C(2)(a)(iii), immediately preceding subsection (2)(b), allows for payment into a beneficiary fund with effect from 1 November 2008. We know that no beneficiary funds had been registered *prior* to 1 January 2009. On a strict interpretation, it seems as if the legislature allowed for the payment into unregistered beneficiary funds for the period from 1 November 2008 to 31 December 2008. I do not believe that this was the intention though; the legislature could never have intended that a death benefit be paid into a fund that is not registered, and neither should the rules of a fund allow for that.

This unfortunately still leaves us with a problem as to how death benefits should be dealt with in the period from 1 November 2008 to 31 December 2008 – a fund may not pay a death benefit to a trust nominated by the trustees, and cannot pay a benefit into a beneficiary fund, because the beneficiary fund has not been registered yet. In my opinion, there is nothing that precludes the trustees from resolving that a death benefit be paid into a beneficiary fund with effect from 1 November 2008. That resolution is however not capable of being executed until the beneficiary fund is registered. My suggestion is therefore that the administrator waits until the beneficiary fund is registered and then only executes the resolution. In cases of dire need the administrator can also pay the benefit in instalments to the beneficiary pending the registration of the beneficiary fund and then transfer the remaining benefit to a beneficiary fund upon its registration.

As pointed out in Legal Update FAW 1/2009, a beneficiary fund could only operate with effect from 1 January 2009 if it was registered as such on that date and its administrator was approved as an administrator in terms of section 13B of the Pension Funds Act. Towards the end of 2008 it became evident that neither of these two requirements would be met. The Financial Services Board (FSB) then issued Information Circular 10 of 2008 on 11 December 2008, which provided for exemption from the provisions of section 13B until 31 March 2009, on certain conditions. This allows those administrators who met the conditions set by the FSB to temporarily administer those beneficiary funds until the section 13B approval is granted on or before 31 March 2009. In addition, the FSB provisionally approved the rules of beneficiary funds, if those rules were submitted to them on or before 31 December 2008.

Apparently there are a few beneficiary funds that have already been registered by the FSB and approved by the South African Revenue Service (SARS).

Regarding the transfer of a benefit from a retirement fund to a beneficiary fund, the FSB has confirmed that section 14 will not apply. The transfer can therefore be done by way of a Recognition of Transfer (ROT) Form.

SARS has advised as follows with regards to the tax position in respect of beneficiary funds:

1. The transfer of assets from a retirement fund to a beneficiary fund is a tax-free transaction.
2. Beneficiary funds do not have to apply to SARS for the tax approval of their rules, as they will not be paying any of the benefits referred to in the Second Schedule to the Income Tax Act No. 58 of 1962 (the Act).
3. Beneficiary funds are however obliged to comply with the requirements of the Fourth Schedule to the Act as "employers" who pay "remuneration", defined the same way as trusts have been doing.

### **Payment of death benefit in respect of a minor to a guardian vs payment into a beneficiary fund**

Trustees often resolved to pay the benefit in respect of a minor beneficiary into a trust instead of to the guardian of that minor without even assessing the competency of the guardian to administer the financial affairs of the minor. The Pension Funds Adjudicator has on numerous occasions criticised trustees for this, pointing out that trustees cannot follow a rigid policy in terms of which all death benefits in respect of minors are paid to trusts. In the complaint of MM Ramanyelo against the Mine Workers Provident Fund in 2004, the Adjudicator summarised the factors to be considered by the board in determining whether a guardian should administer monies on behalf of the minor child as follows:

1. The amount of the benefit.
2. The ability of the guardian to administer the money.
3. The qualifications (or lack thereof) of the guardian to administer the money.
4. The benefit should be utilised in such a manner that it can provide for the minor until they become adults.

It is a common law right for a guardian to administer the financial affairs of the minor child. Only in the event that the trustees find that the guardian is incompetent, there would be grounds for depriving the guardian of this right. The introduction of beneficiary funds does not change this principle. Payment to a guardian (and now also a caregiver) should not be made as a last resort (with payment into a beneficiary fund being the preferred method of payment); instead, payment into a beneficiary fund should only be considered if the trustees are convinced that the guardian or caregiver should not administer the benefit on behalf of the minor child. In relation to the enquiry regarding the competency of the guardian to manage and administer the financial affairs of the minor, the trustees can take account of the guardian's level of education, occupation, own income, own savings, residence, credit worthiness and assets acquired.

Hettie Joubert  
Legal adviser at FundsAtWork  
Momentum

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