Legal updates

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Section 37C – Distribution of retirement fund lump sum death benefits

This update discusses the distribution of death benefits in a retirement fund under section 37C of the Pension Funds Act and related issues.

A. Section 37C of the Pension Funds Act

Section 37C of the Pension Funds Act 24 of 1956 (“the Act”) governs the distribution and payment of lump sum benefits payable on the death of a member of a pension fund, provident fund, pension and provident preservation fund and retirement annuity fund. These benefits are colloquially known as “death benefits”. They do not form part of the assets in a deceased member’s estate. Instead, section 37C places a duty on the trustees of the fund to allocate and pay the benefit in a manner that it deems fair and equitable and only in three exceptional circumstances, may the benefit be paid to the estate. This duty is three-fold and requires that the trustees identify the dependants and nominees of the deceased member, effect an equitable distribution of the benefit amongst the said dependants and nominees, taking into account relevant factors, and to select an appropriate mode of payment for the benefit.

B. The rationale behind section 37C

Section 37C limits the testamentary freedom of a member, in that the member is not able to dispose of his death benefit as he wishes, as he would the other assets in his estate. Even though the member usually completes a nomination form, such nomination is not binding on the trustees, as the benefit must be distributed strictly in accordance with section 37C. This limitation on the common law right to testamentary freedom is justified if one considers the important socio-economic purpose underpinning section 37C. In *Mashazi v African Products Retirement Benefit Provident Fund 2003 (1) SA 629 (W),* the High Court reasoned that in requiring the board of trustees to exercise its discretion when paying a death benefit, the state (at least in theory) ensures that the monies in respect of which it allowed major tax concessions are utilised for the benefit of the deceased member’s surviving spouse, children and other persons dependent on him, thereby reducing the State’s liability.

C. Section 37C overrides other laws

Section 37C overrides any other laws to the extent that these laws are contradictory to its provisions.

In *Makume v Cape Joint Retirement Fund [2007] JOL 19999 (C),* the High Court found that a death benefit was not subject to the marital property regime of the deceased member. The court held that the wording of section 37C leaves no room for an interpretation that half of the benefit accrues to the surviving spouse automatically by virtue of her marriage to the deceased being in community of property.

In *Sithole v ICS Provident Fund [2000] 4 BPLR 430 (PFA),* the Pension Funds Adjudicator ("PFA") held that section 37C takes precedence over any law, including customary law, and overturned the board's decision to pay the benefit to the grandmother of the deceased, who was also the sole nominee, even though the deceased member was survived by a spouse and three children. The board had decided to pay the benefit to the grandmother, as in terms of customary law she was the head of the household.

The beneficiaries reaching a settlement agreement on the distribution of a death benefit also does not absolve the trustees from accountability under section 37C. In *Matene v Noordberg Group Life Assurance Scheme (2) [2001] 2 BPLR 4788 (PFA),* beneficiaries had agreed on the distribution of a death benefit. Subsequently, one of the beneficiaries lodged a complaint with the PFA. The PFA found that the trustees were ultimately responsible for the distribution of the benefit and could not argue that because the beneficiaries agreed to the distribution, the decision was not open to challenge. The PFA also reiterated that a person can only benefit in terms of section 37C if he was either a dependant or a nominee. That the beneficiaries agreed to a distribution that included non-dependants and non-nominees, did not make the unlawful distribution lawful.

D. What constitutes a death benefit?

The Act defines "benefit" as any amount payable to a member or beneficiary in terms of the rules of the fund.

Section 37C provides that the section applies to any benefit, other than a benefit payable as a pension to the spouse or child of the deceased member, payable by a fund upon the death of a member. Benefits payable in the form of a pension are dealt with in terms of the rules of a fund.

A death benefit is protected in terms of section 37A and is only subject to the deductions provided for in section 37D of the Act. The PFA emphasised this in *Mlungesi v Anglo American Property Fund* (*1) [2001] 4 BPLR 1878 (PFA)* where the fund deducted an advance on the funeral benefit and paid this amount over to the beneficiaries. The PFA held that this was not a permissible deduction in terms of section 37D and was unlawful.

A death benefit does not accrue if a member withdraws or retires from a fund but then dies before his withdrawal or retirement benefit is paid out. It is the initial exit event that will determine whether or not section 37C applies. Information Circular 2 of 2010, published by the Registrar of Pension Funds, confirms this principle.

In *Ngwenya v Scribante Construction (Pty) Ltd [2003] 2 BPLR 4404 (PFA)*, the PFA dealt with whether or not the member needs to be in service at the time of death in order for section 37C to apply. In this case, the employer argued that the member was not in active service at the time of his death as he was off sick and did not attend to his duties. The PFA held that the critical issue was whether a cancellation of the employment contract had taken place. In this case the member's employment contract had not been cancelled and furthermore, the payment of contributions had continued for this member. The PFA concluded that the member was still in service and that consequently a death benefit was payable. See also *Mokoatle v Commercial Industries National Fund (1) [2002] 1 BPLR 2989 (PFA),* where the PFA confirmed this principle.

From the above, in occupational funds, it is clear that section 37C applies to lump sum benefits that become payable on the death of a member while he was still in the service of the employer. The benefit is subject only to deductions permitted in terms of section 37D.

E. The requirements of section 37C

Section 37C caters for the following four scenarios – Where the deceased is survived by:

1. Dependants only (no nominees) – sub-section (a)
2. Nominees only (no dependants) – sub-section (b)
3. Dependants and nominees – sub-section (bA)
4. No dependants and no nominees – sub-section (c).

F. Dependants

In terms of the Act, the following persons will be considered a dependant:

(a) <u>a person in respect of whom the member is legally liable for maintenance</u>

Persons falling into this category are referred to as "legal dependants" because the member was legally obliged to maintain these dependants financially. The most common examples of legal dependants are a minor child, an adult child who is still studying, a grandchild, parent or grandparent in need of support. A former spouse in receipt of maintenance in terms of a divorce order will also be considered a legal dependant for the purposes of this section.

In order to qualify as a legal dependant, the person claiming a share of the benefit must be able to show that he required financial support and that the deceased, at the time of his death, had the financial means to provide that support.

In *Wasserman v Central Retirement Fund (1) [2001] 6 BPLR 2160 (PFA)* the PFA held that it is not necessary for a legal dependant to show that he was actually receiving financial support from the member at the time of his death. It is sufficient that the dependant's need and the member's ability to meet that need existed at the time of death.

In *Fourie v Central Retirement Annuity Fund 2001 2 BPLR 1580* and *Zikhali and Another v Metal Industries Provident Fund (2) [2002] 5 BPLR 3494 (PFA)*, the PFA, referring to the case of *Stander v Royal Exchange Insurance Company 1962 (1) SA 454 (SWA)*, found that there is a legal duty on the child to pay maintenance towards his parents. However, the parent must show that they are unable to support themselves, i.e. there must be a necessity for support.

(b) <u>a person in respect to of whom the member is not legally liable for maintenance, if such person –</u>

(i) <u>was, in the opinion of the board, upon the death of the member in fact dependent of the member for maintenance</u>

Persons falling under this category are those who were in fact financially dependent on the deceased member at the time of his death in that they received some form of *regular* financial support from the member. Once-off payments are not sufficient to establish dependence. Any support that has a monetary value falls within the scope of financial support. This includes rent-free accommodation, groceries and assistance with medical expenses.

What constitutes maintenance is not limited to basic necessities, but rather depends on the quality and standard of living and the individual circumstances in each case. In *Jacobs v Road Accident Fund (A402/2008) [2011] ZAGPPHC 121*, the High Court ruled that what was required of parents claiming financial dependency was just that they are able to demonstrate that they relied on their child for basic necessities. However, what constitutes basic necessities will depend on the parent's station in life.

Cohabitees and life partners were initially treated as factual dependants and were required to prove that they were actually dependent on the deceased. However, the Act has been amended to include life partners under the definition of "spouse".

(ii) is the spouse of the member

Spouse includes a permanent life partner, spouse or civil union partner of a member in terms of the Marriages Act, the Civil Union Act or the Recognition of Customary Marriages Act. Refer to paragraph **B3 of Legal Update 5-2015** for a discussion on the impact of different marital regimes on the distribution of section 37C benefits. A separated spouse will also qualify as a dependant for the purposes of section 37C.

(iii) is a child of the member, including a posthumous child, an adopted child or a child born out of wedlock

This category includes all children of the deceased, both biological and adopted and children who have reached the age of majority or are financially independent.

(c) a person in respect of whom the member would have become legally liable for maintenance had the member not died

This category refers to "future dependants" i.e. people that the member would have become legally liable to maintain had he not died. Examples of possible future dependents include elderly parents, a fiancée, and an applicant who has lodged an application for maintenance in terms of the Maintenance Act.

Once the trustees have identified all the dependants of a member, they must move on to the second step of the enquiry which is determining the extent of each dependant's financial dependency on the member.

G. Nominees

The board must establish if the member nominated any person to receive a portion of his benefit. While the Act does not define a nominee, it is clear that the nomination must be in writing and the nominee must be a person who does not qualify as a dependant of the member.

A nomination must –

1. specify who the nominee is;
2. be in writing;
3. be communicated to the fund; and
4. specify the portion of the benefit that is allocated to the nominee.

The nomination must be completed while the member belonged to the fund. *In Bosch v White River Toyota Provident Fund [2001] 3 BPLR 1702 (PFA),* the member completed his nomination form and then terminated his employment with the employer, at which point he was paid a withdrawal benefit in terms of the rules of the fund. The member later re-joined the employer and his membership to the fund started afresh. He did not complete a nomination form when he re-joined the fund. Upon the member's death it was argued that the fund should pay the benefit in accordance with the initial nomination form. The PFA held that the nomination form did not apply to the member's death benefit as it was completed before his membership was terminated and could not be applied to the current benefit.

The nominee must survive the member. In *PPS Insurance Company v Mkhabela (1959/2011) [2011] ZASCA 191*, the SCA held that a nominee's estate could not receive a portion of a death benefit where the nominee died before the member. The principle that a nominated beneficiary does not acquire any right to the proceeds of a policy during the lifetime of the policy owner also applies to a death benefit under the Pension Funds Act. It is only on the member's death that the nominated beneficiary is entitled to a benefit. Until the member dies, the nominated beneficiary only has a *spes* (an expectation) of claiming the death benefit – the nominated beneficiary has no vested right to the benefit. If the nominated beneficiary dies before the member, they would have had no right to any benefit under the Pension Funds Act at the time of the member's death. The *spes* falls away.

Where a member incorrectly describes a nominee, the nominee is allowed to bring extrinsic evidence to show that he is in fact the intended nominee. This principle was confirmed by the PFA in *Zulu v Illovo Sugar Provident Fund [2002] 2 BPLR 3129 (PFA)* where a nominee named Phikaphu was described as Pikabu in the nomination form.

Where a member nominates a dependant to receive a portion of his death benefit, the trustees must treat that person as a dependant and not as a nominee. The trustees must then follow section 37C(1)(a).

A nominee will only *automatically* qualify for the percentage of the benefit expressed in the nomination and be entitled to a share of the member's death benefit if –

a) there are no dependants;
b) the member's estate is solvent;
c) the nominee is still alive at the time when the trustees make their decision; and
d) the nominee was not responsible for the member's death.

If there are dependants and nominees, the nominee does not automatically qualify for a portion of the death benefit. Section 37C(1)(bA) will then apply. The trustees have to take all relevant factors into consideration in deciding on the allocation between the dependants and the nominees.

A member may not nominate his estate as a beneficiary. Section 37C allows for payment into an estate only in circumstances where the estate is insolvent and there are only nominees, or where there are no dependants or nominees. The PFA confirmed this in *Martin v Beka Provident Fund [2000] 2 BPLR 196 (PFA)*.

H. The legal status of a nomination form

Our courts and the PFA have held that any nomination made by a member is not binding on the trustees; it serves merely as a guide to the trustees and is one of the relevant factors that must be considered by the board in arriving at an equitable distribution. See *Mashazi v African Products Retirement Benefit Provident Fund* [2002] 8 BPLR 3703 (W) at 3706B–D; *Kaplan and Another v Professional and Executive Retirement Fund and others* [2001] 10 BPLR 2537 (A) at 2539I–J; and *Van Zeler v Sanlam Marketers Retirement Fund and others* [2003] 2 BPLR 4420 (PFA) at 4426A–G.

I. The doctrine of *functus officio*

The *funtus officio* principle means that an administrative official, when exercising a public power, cannot change his decision once a final decision has been reached.

It is important to note that the doctrine of *functus officio* applies to a board when it distributes benefits in terms of section 37C. This is so because the board is exercising a power derived from a statute and this power is of a public nature and therefore, the principles of administrative law apply.

In *Titi v FundsAtWork Umbrella Provident Fund (1728/2010) [2011] ZAECMHC 22*, the High Court held that a board, when acting in terms of the provisions of the Act and administering the funds on behalf of its members, is exercising a public power. The decisions which it is empowered to take in terms of 37C of the Act, and in particular the power to effectively override the express wishes of its members, may conceivably affect members of the public. Any decision made in pursuance thereof and which could negatively impact on members of the public would therefore be subject to judicial scrutiny and review in terms of the provisions the Promotion of Administrative Justice Act.

The fact that the board performs an administrative duty in distributing death benefits, means that is *functus officio*. The implication of this is that once a final resolution is adopted, the board cannot set aside its decision and reconsider the matter.

The board's initial decision or resolution will stand until it is set aside by a competent authority, which may be the PFA or the High Court.

J. Duty to conduct a reasonable investigation

Section 37C requires that the trustees actively trace dependants and investigate the extent of their dependency on the deceased member.

The PFA found in *Itumeleng v SALA Pension Fund [2007] 3 BPLR 311 (PFA)* that a board of trustees was not entitled to simply wait for dependants to come forward. They had to be proactive in locating dependants. On the facts of this matter, the PFA suggested that the fund should have placed advertisements in newspapers circulated in the area where the member lived or worked in an effort to contact dependants. The PFA went on to state that although the fund can rely on the employer to furnish it with information on dependants, it could not abdicate this duty and rely solely on the employer. If the employer is uncooperative, the fund must employ alternate means of tracing dependants.

K. Effecting an equitable distribution

<u>Section 37C(1)(a) – dependants only</u>

In terms of section 37C (1) (a) of the Act, when the deceased is survived by only one dependant (either factual or legal), that dependant must receive the entire benefit. If there is more than one dependant (either factual or legal), the board has a duty to effect an equitable distribution amongst them.

<u>Section 37C(1)(b) – nominee/s only</u>

Payments under this section are subject to a 12 month waiting period after the date of the member's death and only if no dependants were identified within that period. In this case, the board does not have to effect an equitable distribution. If the board if satisfied that there are no dependants after the 12 month period has passed, and if the member's estate is solvent, the board can go ahead and make payment to the nominees in accordance with the nomination form. The board is not permitted to deviate from the nominations as specified and no nominee should receive a greater portion than the member intended for him to receive. The nominee is only entitled to receive the portion of the benefit as specified in the nomination form. If the member's estate is insolvent, the amount required to make up the shortfall must first be paid into the estate. The remaining amount must be distributed among the nominees, in the proportions set out in the nomination form. If the member only nominated beneficiaries to receive a portion of the benefit, the remainder must be paid into the deceased member's estate.

<u>Section 37C(1)(bA) – dependants and nominees</u>

In cases where the member has nominated a nominee and is survived by dependants, the trustees are required to consider the circumstances of all the beneficiaries. The PFA clarified the requirements in *Gowing v Lifestyle Retirement Annuity Fund [2007] 2 BPLR 212 (PFA*) where he held that a board was incorrect in assuming that once a dependant is identified, the claim of a nominee fell away. Further, the PFA found that a nominee was not required to prove any dependency on the deceased. The entitlement of a nominee flows from the fact that he was *nominated* by the deceased.

Section 37C(1)(c) – estate

Where the fund could not trace any dependants within 12 months of the member's death, and the member has also not nominated a non-dependant beneficiary, the death benefit will be paid into the deceased member's estate. If the member does not have an estate, the benefit will be paid into the Guardian's Fund or an unclaimed benefits fund.

L. Determining the extent of dependency

In determining whether or not to include a dependant in the distribution of the benefit, the trustees must consider relevant factors which include, but are not limited to:

- the extent of dependency;
- the ages of the beneficiaries;
- the relationship with the deceased;
- the amount available for distribution;
- the financial status of each beneficiary, including the future earning capacity of each beneficiary; and
- the wishes of the deceased.

These factors were set out in the matter of *Sithole v ICS Provident Fund [2000] 4 BPLR 430 (PFA)* and more recently confirmed in the matter of *Mohlomi v Evergreen Provident Fund and others [2014] JOL 31440 (PFA).* The PFA in *Sithole* held that no single factor may be emphasised to the exclusion of the other factors. The above list is not exhaustive as relevant factors will depend on the circumstances of a particular case.

M. Period for payment

In the matter of *Dobie NO v National Technikon Retirement Pension Fund [1999] 9 BPLR 29 (PFA),* the PFA set out the following periods within which the death benefit must be paid.

1. Section 37C(1)(a): Only dependants, no nominated non-dependant beneficiaries

   The fund must pay the benefit within 12 months from the date of the member's death. There is no duty to pay until the board has made a decision as to who the beneficiaries are and what portion of the death benefit should be allocated to each beneficiary.

   The PFA specified that this section "defines the period available for tracing dependants before making payment exclusively to a nominee. Hence, if the board is reasonably satisfied that it has traced all dependants, the stipulated period does not pose any limitation upon the distribution to the dependants. The provision does not prohibit distribution of the benefit within 12 months. Nor does it compel distribution at the expiry of the 12 month period".

2. Section 37C(1)(b): No dependants, only nominated non-dependant beneficiaries

   The fund can only pay the benefit after the expiry of 12 months from the date of the member's death. The PFA explains this as follows: "Performance in this instance, therefore, becomes due by virtue of the operation of the statute on expiration of 12 months after the death of the member. The fund does not have to exercise any discretion in that regard. The board's function is purely administrative or ministerial. It merely has to satisfy itself that the 12 month period has lapsed and a nominee has been designated in writing. If the two pre-conditions are met, the nominee is entitled to payment, a duty to pay arises immediately upon the expiry of the 12 month period." Payment can only be made to nominated non-dependant beneficiaries to the extent that the deceased member's estate is solvent. Put differently, if there is a shortfall in the deceased member's estate, that shortfall must first be met out of the death benefit before the nominated non-beneficiaries' entitlement arise.

3. Section 37C(1)(bA): Both dependants and nominated non-dependant beneficiaries

   Payment must be made within 12 months from the date of the member's death, similar to a distribution under section 37C(1)(a).

4. Section 37C(1)(c): No dependants or nominated non-dependant beneficiaries

   In this case, payment will be made to the deceased member's estate. This section does not specify a timeframe or require that the trustees take a specific decision to pay the benefit to the estate. Generally, the estate will only be entitled to payment at the expiry of 12 months from the date of the member's death.

5. Section 37C(1)(c): No dependants, only nominated non-dependant beneficiaries, but estate is not solvent, or only nominated non-dependant beneficiaries for a portion of the benefit

   In both these cases, the trustees must distribute the benefit between the nominated non-dependant beneficiaries and the estate. The same principles as set out in paragraphs 2 and 4 above will apply – the nominated non-dependant beneficiary and the estate will only be entitled to payment at the expiry of 12 months from the date of the member's death.

N. Mode of Payment

The final obligation on the board is to determine an appropriate mode of payment of the benefit.

<u>Payment to a minor beneficiary</u>

While there are no PFA determinations or court cases dealing specifically with payment made directly to a minor, it is widely held that a benefit should only be paid directly to a minor in exceptional circumstances.

After deciding not to pay the minor directly, the next decision is whether or not the guardian of the minor should receive the benefit. In *Baloyi v Ellerines Holdings Staff Pension Fund [2005] 7 BPLR 606 (PFA)*, the PFA found that as a legal guardian, the parent of a minor child has a duty at common law to administer the assets of the minor child. Thus, payment to a minor's guardian should be effected in the normal course of events unless there are cogent reasons for depriving the parent of this duty.

In *Ramanyelo v Mineworkers Provident Fund 2005 1 BPLR 67 (PFA)*, the PFA set out the following factors to be considered when a board is deciding on whether or not to effect payment of the minor's benefit to his guardians as follows:

- the amount of the benefit;
- the qualifications (or lack thereof) of the guardian to administer the monies;
- the ability of the guardian to administer the monies; and finally
- the benefit should be utilised in such a manner that it can provide for the minor until he attains the age of majority.

In this case, the fund in question adopted a policy that any benefit over R20 000 would be paid into a trust for the benefit of the minor child. The PFA held that the board had fettered its discretion in adopting a blanket policy and that it had failed to consider relevant factors in determining how the benefit should be paid.

In instances where the guardian has expressly indicated that he intends to use the minor's benefit for a purpose other than to cater for the minor beneficiary's needs, the PFA has held that the board was correct in paying the benefit into a trust.

The PFA has also dealt with cases where payment of a minor's benefit was made to someone other than the minor's guardian and in such instances has held that there may be circumstances that necessitate payment of a minor's benefit to someone other than a guardian, where the minor has a caregiver who is not his guardian.

Payment to a major beneficiary

Where a benefit has been allocated to a major dependant or nominee, then, in the normal course of events, it should be paid directly to that dependant or nominee.

Section 37C(4) provides that the benefit can also be paid to a major beneficiary in instalments. However, the major beneficiary must agree and the agreement must be in writing.

Since 2008, the board now had the option of paying a major beneficiary's benefit into a beneficiary fund. The PFA has held that payment directly to a major beneficiary is the norm and the benefit should only be paid into a beneficiary fund if the board is of the view that the major beneficiary is incompetent to administer his own finances.

In *Vellem* (*obo Vellem*) *v Auto Workers Provident Fund and Another* [2014] 1 BPLR 134 (PFA), the PFA found that the board was correct in paying a major beneficiary's benefit into a beneficiary fund, as the beneficiary in question was found to be mentally challenged and had applied for a disability grant. The PFA found that it was clear, in this case, that the beneficiary was unable to manage his financial affairs and that the board had chosen the appropriate mode of payment for the major under the circumstances.

O. The beneficiary's choices

Lump sum

The beneficiary can choose to receive the total or a portion of the benefit allocated to them as a lump sum. The lump sum will be taxed on the retirement tax table, which means that the first R500 000 (or such other amount if the table changes) will be tax free, unless a previous lump sum benefit was paid in respect of that member, in which case the tax free amount will be reduced by that previous tax free amount.

Annuity

The beneficiary can choose to receive the total or a portion of the benefit allocated to them as an annuity. The beneficiary can choose the annuity provider. The amount used to buy the annuity will not be taxed, but the income from the annuity will be subject to tax.

Transfer to another fund not allowed

The Income Tax Act does not allow for the transfer of a death benefit to another fund.

Beneficiaries are advised to consult with their financial adviser before deciding on how their portion of the death benefit should be paid.

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