

IRF LEGAL & TECHNICAL COMMITTEE

COMMENTS ON NATIONAL TREASURY DISCUSSION DOCUMENT: SHARING OF PENSION BENEFITS ON DIVORCE

The discussion document looks at various aspects of retirement fund reform, including divorce. This is covered in paragraph 3.17 of the document. For these purposes, the Task Team looked at the provisions of the Divorce Act relating to the sharing of pension benefits on divorce, and to the proposals of the Mouton Committee Report and of the SA Law Commission. It seems opportune then to perhaps first touch on the Legal and Technical Committee's previous discussions on the Divorce Act and the Law Commission's most recent efforts in this regard.

DIVORCE ACT

1. Prior to 1989, conflicting views prevailed, but the legal situation was that a divorcing spouse had no access to his/her former spouse's retirement benefits. Not only was this very often the most significant potential asset, but it also left a spouse who had contributed to the marriage as a homemaker with no post-retirement funding. The Divorce Amendment Act 7 of 1989 introduced into our law the concept of the sharing of pension benefits (pension interest) upon divorce by deeming pension interest to be an asset on divorce.
2. Unfortunately it has become clear over time that while the intention behind the legislation was admirable, it fell short in a number of respects. The major criticism is:
 - 2.1 The basis for calculating pension interest. This is effectively the minimum notional benefit that would be payable in terms of the fund's rules at divorce date. In many instances this consisted of nothing more than member contributions with a small fixed rate of interest.
 - 2.2 Provision is not made for the non-member spouse's allocation to accrue interest or capital growth after the divorce date, probably because this would not be consistent

with the endorsement mechanism. This exacerbates the situation referred to above.

2.3 The lack of a clean break approach inherent in the endorsement mechanism. Because payment of the allocation to the non-member spouse depends on the accrual of the benefit to the member spouse, the parties could remain financially tied to each other for years following the divorce. In the event of the non-member spouse dying before accrual, her estate must remain open until the benefit accrues.

2.4 The ambiguity and lack of clarity in the legislation. For example:

- In some respects the Act implies that pension interest is automatically included when a joint estate is divided and in others it implies the opposite. This has led to numerous disputes and even conflicting decisions by our courts (compare for example *Sempapalele v Sempapalele* and *Maharaj v Maharaj*).
- The general view of the industry has always been that the pension fund concerned can only effect an endorsement and payment if the court expressly orders it (by name) to do so. The Act does not expressly state as much, and this is only apparent from the Law Commission's reports on the Act and a clear interpretation thereof. Again, this is a source of unnecessary disputes.
- It is not always clear what is meant by the accrual of a benefit. Hopefully this has been largely laid to rest by the recent matter of *Old Mutual v Swemmer*. However there are contradictory views on whether a transfer to an approved fund or a section 14 transfer constitutes accrual.
- The lack of specified procedural requirements.
- The Act is silent on the taxation of the allocation. This has led to disputes in the Income Tax Special Court and an unsatisfactory amendment to the Second Schedule of the Income Tax Act.

- 2.5 A fall in the markets or the existence of prior or preferential claims against a member spouse's benefit (e.g. a housing loan or guarantee or a valid maintenance court attachment) can create a situation where a fund is potentially obliged to pay an amount to the non-member spouse that exceeds the balance held for the member spouse.
- 2.6 The wording of the Act apparently contemplates that the ex-spouse's allocation can be paid only as a once-off lump sum, which creates a problem when the benefit from which the allocation must be deducted is, in terms of the fund's rules, payable only as an annuity.
- 2.7 Related to the above two issues, problems are created when the value of the non-member spouse's allocation exceeds the maximum commutable portion of a retiring member spouse's benefit. This has led to funds applying matters differently, and potentially contravening legislation.
- 2.8 The Act preceded so-called preservation funds and thus makes no provision for the sharing of a spouse's interest in such a fund. The wording of the Act is also not flexible enough to incorporate such a fund.
- 2.9 The method of effecting a deduction at benefit accrual, coupled with the tax issue, discourages pension preservation by the member after leaving service.
- 2.10 The Act does not cater for the dissolution of relationships other than marriages at civil law, and even then only for marriages in community of property or under the accrual regime. It excludes marriages out of community of property, unions at customary law or according to the tenets of Asiatic religions and domestic partnerships.

The result is that spouses who are eligible for such an order must be regularly prejudiced by the negligence of their attorneys. Where orders are valid, the non-member spouse often receives a token allocation which may be further eroded by inflation or the member spouse's retirement planning is severely compromised. Either way, the fund or administrator is left to deal with the mess.

Following representations from various parties, including input from the retirement fund industry, the SA Law Commission drafted Discussion Paper 77.

DISCUSSION PAPER 77

3. This paper commences with a critical examination of Act 7 of 1989 and a comparative survey of legislation governing pension sharing on divorce in various countries, before examining the issues, namely the purpose of pensions and matrimonial property dispensations.

The conclusions of the Commission are codified in a draft Bill.

4. The salient points are the following:

- 4.1 The Bill is intended to afford a divorced spouse of a pension fund member the right to share in the retirement fund benefits that will become available or are being paid to the member.

- 4.2 The starting point is that a non-member spouse should have this right automatically and irrespective of the matrimonial property regime, unless:

- The parties have explicitly excluded pension sharing on divorce by way of antenuptial contract; or
- A spouse has in writing waived his/her right; or
- The spouses have by written agreement provided for the settlement of other assets in place of that right.

In other words, the fund concerned will intervene unless one or more of the above exceptions apply.

- 4.3 The non-member spouse's share (50%) will be determined with reference to the duration of the marriage.

- 4.4 The Bill draws a distinction between matured benefits and unmatured benefits and in case of the latter, between defined contribution schemes and defined benefit schemes.
- 4.5 It proceeds from the viewpoint that there is no uncertainty with matured benefits as regards the amount available. All that is needed is to calculate the non-member spouse's share with reference to the duration of the marriage in proportion to the member's total pensionable service in relation to the benefit. The non-member spouse should receive his/her share directly from the fund upon notification.
- 4.6 Because of the structure of a DC fund, a division of the member's unmatured retirement fund benefits can be effected at divorce. The non-member spouse would be entitled to half of the amount accumulated during the period of the marriage.

In this case, a split must be effected on divorce date and the non-member's share transferred to a separate account where it should earn investment returns and be subject to the same rules and payment provisions as the member's benefits.

- 4.7 In a DB scheme, the non-member spouse should upon divorce become entitled to a deferred benefit payable when the member's benefit becomes payable.

The calculation depends upon the type of benefit that becomes payable. In the case of resignation, dismissal or fund dissolution, the non-member spouse's share should be a proportion of the benefits accruing to the member, determined with reference to the benefits accumulated during the period of the marriage in proportion to the total period during which benefits have been accumulated.

In the case of benefits payable upon other contingencies, the non-member spouse's share should be determined with reference to the period during which pensionable service was accumulated during the period of the marriage, in proportion to the total period during which pensionable service was accumulated and the actuarial liability of the fund in respect of the member on the day preceding the day on which the benefit becomes matured. Special provision is made for the intervening death of the member.

4.8 In the case of an unmatured benefit in a DB fund, if the non-member spouse dies before payment is effected, his/her estate will have a claim against the administrator.

4.9 The definition of marriage includes those in accordance with customary law or any recognised religion. Because most customary unions are not registered, the Bill provides for a means of proving the dates of commencement and dissolution of such marriages.

The Commission felt that the provisions should not extend to same-sex partnerships, as these are not recognised as marriages in our law, nor to heterosexual cohabitation as these partners are entitled at law to formalise their relationships.

5. The document is a step in the right direction when it comes to addressing the above issues, and many aspects are welcomed. However, reservations were expressed.

5.1 These provisions envisage a drastic change to matrimonial property law and pension law. If these provisions are legislated, every married person who is a member of a retirement fund at enactment will be at a distinct disadvantage; there will almost certainly be no existing agreement or waiver, and most laypersons will probably remain ignorant of their rights in this regard for many years after enactment. Any subsequent divorce could have drastic and unforeseen consequences for his/her retirement planning.

5.2 It appears that in the case of unmatured funds, the intention is that the non-member spouse acquires rights akin to those of a member. The possible implication is that he/she:

- Has access to the options that a member has (e.g. to elect a benefit option; member investment choice);

- Has a right to benefits in terms of the rules (e.g. a pension at normal retirement age, including any spouse's pension options or the payment of death benefits);
- Must be regarded as a member for purposes of section 37C;
- Can demand the right to elect a member representative;
- Will acquire the rights of a deferred member in terms of the Second Amendment Act of 2001, which also has implications with regard to GN35;
- May be entitled to be included in the distribution of surplus.

At the same time, this has cost implications for the fund (unfunded liabilities and further administration costs) and increases the ambit of its risk exposure.

5.3 The discussion paper was published 3 years before the Pension Funds Second Amendment Act. The concept of minimum benefits would obviously have an effect on the proposals, as will the definitions of defined benefit and defined contribution funds.

6. The general consensus was that the proposals perhaps went too far by making the right of the non-member spouse automatic rather than a provision upon divorce, and that the parties should have more latitude in this regard, as is the case at present. In the circumstances, there appears to be no need to enact dedicated legislation; instead, the Divorce Act could be amended in such a way that the current disadvantages and problem areas are eliminated.

National Treasury' s Proposals

7. The National Treasury Task Team's recommendation is that:

7.1 The member's minimum individual reserve (MIR) (the Task Team recommends that this concept created by the Second Amendment Act of 2001 be incorporated in the legislation that succeeds the Pension Funds Act) be deemed to form part of his/her assets available for splitting on divorce.

- 7.2 If the court orders the division of the member's MIR, it must be split between the parties on the basis determined by the court.
 - 7.3 The benefit due to the member in respect of service prior to divorce should be reduced in the proportion that the residual amount of his/her MIR bears to his/her MIRI immediately prior to divorce.
 - 7.4 The member's former spouse should thereafter be deemed to be a member of the fund with a paid-up MIR equal to the portion awarded by the court. If left in the fund, the former spouse's benefit will grow with investment return on a DC basis. He/she should be given the option to transfer his/her share to an individual retirement fund, or an occupational retirement fund in which he/she participates.
 - 7.5 The former spouse will thereafter have no claim against the member's residual interest in the fund.
8. What is immediately apparent is that the proposal borrows from both the Divorce Act (for example by deeming MIR to be an asset only for purposes of divorce and requiring an express order of court) and Discussion Paper 77 (for example, deeming the former spouse to be a fund member and proposing an immediate allocation rather than an endorsement). This addresses the problems of the low value of pension interest and punts the clean break approach, without necessitating sweeping and prejudicial changes to our law.
 9. It is not apparent what statute should be the vehicle for any legislation that may arise from the proposal. Given the fact that this refers to divorce, the implication is that domestic partnerships are excluded, in which case the Divorce Act would appear to be the appropriate vehicle, as proposed above.
 10. The most immediate problem lies with deeming the former spouse to be a member. As we point out above, this could have numerous implications. Moreover, if the fund is a DB scheme, it seems inconsistent to require that it must treat former spouses as special DC members.

11. The proposal is obviously intended as nothing more than a framework. We request that any proposed legislation that eventually comes out of this takes into account the issues raised above as well as the following:
 - 11.1 The legislation needs to recognise that a member may have more than one former spouse making a claim on his MIR, or that there may be other claims that may enjoy preference, such as a housing loan or guarantee or a valid maintenance order. Specific provisions must address this.
 - 11.2 The legislation must specify whether the provisions also apply if the member had already retired from the fund before divorce. It must also address the method of effecting payment to the former spouse if the member's benefit is paid as an annuity.
 - 11.3 Provision must be made for what happens on the death of either of the parties after divorce. As regards the member, even if section 37C in its present form is done away with as proposed by the Task Team, a member's surviving spouse or minor child should not be penalised on his/her death by the provisions of a divorce order. As regards former spouses, if section 37C is merely resurrected in another form in the new retirement fund legislation and will apply to them as "deemed members", the already onerous duty on trustees will be exacerbated.
 - 11.4 The rights of the former spouse as a deemed member need clarification in general.
 - 11.5 Provision needs to be made for substantive and procedural requirements. For example, what wording is required, whether the fund must be named, the prescribed method of notifying the fund, the citing of the fund, etc.
 - 11.6 Provision needs to be made for the fund or administrator to deduct a once-off fee for the initial splitting, and to levy a periodical administration fee where it must hold an amount for the non-member spouse or pay it to him/her in the form of an annuity (if this will be permitted).
 - 11.7 The tax issue needs to be clarified. The current regime is not consistent with the clean break approach, and is rather unfair toward the member.