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Dear Alta

## UMBRELLA TRUSTS

1. I mentioned to you that I would, in the light of the brief you have been given to research issues affecting death benefit payments to umbrella trusts, send to you a review on the learnings and my observations that I have on this.
2. The term "umbrella trust" is not one that enjoys statutory recognition. However, it is a concept that has emerged to provide in the main for death benefits paid in terms of section 37C(2) of the Pension Funds Act, No. 24 of 1956 ("the PF Act"). As you know, in terms of section 37C of the PF Act the benefit on the death of a member is payable to a dependant or nominee ("the beneficiary") of that deceased member, and failing both dependants and nominees, to the estate of the deceased member.
3. In this review I shall consider the provisions of the PF Act, the Trust Property Control Act, No. 57 of 1988 ("the Trust Act"), the Financial Advisory and Intermediary Services Act, No. 37 of 2002 ("the FAIS Act") and the Administration of Estates Act, No. 66 of 1965 ("the Estates Act").

## **THE PF ACT**

4. In terms of section 37C of the PF Act once the board of a retirement fund ("the board") has identified who must benefit from the death benefit then such death benefit can be paid directly to that beneficiary (section 37C(1)) (or his or her guardian, curator bonis or trustee, if insolvent), to a trust for the benefit of that beneficiary (section 37C(2)), or in instalments by the fund to that beneficiary (see the provisions of section 37C(3) and (4)). It follows that the board in making a death benefit must decide not only who must receive that benefit but what manner of payment of such death benefit is most appropriate. Furthermore, the payment of the death benefit in instalments by the retirement fund is not permissible unless the rules of the retirement fund permit that (see *Tek Corporation Provident Fund v Lorentz* 1994 (4) SA 884 (SCA), *Mostert NO v Old Mutual* 2001 (4) SA 159 (SCA)).
5. It is in terms of section 37C(2) that the payment to a beneficiary of the death benefit can be paid to a trust for the benefit of that beneficiary. This section reads as follows –

“37C(2) For the purpose of this section, a payment by registered fund to a trustee contemplated in the Trust Property Control Act, 1988 (Act No. 57 of 1988), for the benefit of a dependant or nominee contemplated in this section shall be deemed to be a payment to such dependant or nominee.”
6. From the above it flows that –
  - 6.1. The board fulfils its obligations in respect of a death benefit on payment of the death benefit to a trust for the benefit of the beneficiary in the same way as the payment of a death benefit direct to a natural person.
  - 6.2. The only criterion for making the payment due to a beneficiary instead to a trust for the benefit of that beneficiary, is that this manner of payment (to the trust) must be for the benefit of that beneficiary.
  - 6.3. Section 37C(2) contemplates not merely that the person is entitled to the death benefit must be a beneficiary of that trust, but also that, objectively, the payment to that beneficiary must be beneficial for that person. Thus the decision of the board to make an award to a trust for the benefit of a beneficiary would be fully defensible if that board were able to demonstrate that it had considered the circumstances of the beneficiary and that, notwithstanding the costs associated with the administration of the death benefit in a trust, there was a greater probability of longer term value and benefit for that beneficiary if the death benefit were placed in a trust than if it were not.
  - 6.4. There thus is no bar to placing any death benefit in a trust for the benefit of a person who is not under a legal disability, provided, as stated above, the board can demonstrate that, objectively, payment of this benefit in this manner is the most beneficial form of payment to that beneficiary.
7. The Pension Funds Adjudicator has held, in *Dhlamini v Smith* (2003) 7 BPLR 4894 (PFA), that ordinarily the payment due to a minor beneficiary should be paid to his or her guardian rather than to a trust for the benefit of the beneficiary. With respect, this does not appear to be supported by section 37C(2) since, in my view, all that the board must do is make payment of the death benefit in a manner

which is most beneficial for any such beneficiary under a legal disability. In some instances this may mean payment to a trust for the benefit of that beneficiary even if that beneficiary has a guardian and the board is satisfied that it will be more beneficial for the death benefit to be administered on behalf of the beneficiary by trustees of a trust than by his or her guardian.

8. In my view it is implicit in determining whether payment of a death benefit to a trust is the most beneficial form of payment for a beneficiary that the board establishes that –
  - 8.1. the trustee of that trust is authorised to act in terms of the Trust Act;
  - 8.2. the trustee is licensed if applicable in terms of the FAIS Act; and
  - 8.3. that there is nothing to indicate that the trustee will not administer the death benefit in accordance with his or her fiduciary obligation to the beneficiary.
9. If the board were not to satisfy itself as to the authority in law and competence of any such trustee then, to the extent that the beneficiary benefiting from the death benefit were to suffer any loss as a result of the board not investigating that properly at the time of making the award and such beneficiary could show that any such loss was attributable to the board not carrying out its duties as described above, then that board would be liable to the beneficiary for the loss suffered.
10. By the same token, if the board could not reasonably foresee at the time of making the award of the death benefit to a trustee that such trustee might subsequently mismanage the funds, causing a loss to be suffered by the beneficiary, then such beneficiary would have no right of recourse against that board.
11. Of course, irrespective of whether the board had appropriately satisfied itself as to the authority in law and competence of any such trustee, the trustee will always, in the first instance, be liable to the beneficiary as a result of any loss suffered by that beneficiary which flows from the management of the trust assets.

## **THE TRUST ACT**

12. As stated above, the term “umbrella trust” is not one that enjoys statutory recognition. This is not a term that is found in the Trust Act, which is the main regulatory statute governing testamentary and inter vivos trusts. Usually there is some relationship between the settlor of an inter vivos trust, and the testator of a testamentary trust, and the beneficiaries of each type of trust. This does not exist in respect of any death benefit paid to an umbrella trust. This can be problematic in relation to a death benefit settled on an umbrella trust in respect of a major beneficiary who is not under any legal disability, as is apparent from the discussion below.
13. Typically an umbrella trust is constituted by the establishment of a trust deed registered with the Master of the High Court in terms of the Trust Act. Such a trust deed will provide for the establishment of sub-trusts in respect of each death benefit payable, and the sum of all these sub-trusts will constitute the total assets of that umbrella trust. When the board makes payment of the death benefit usually a deed of settlement or like document is concluded by the fund and the trustee of the umbrella trust in which details of the beneficiary are given, the amount of the death benefit, the details of the deceased member of the fund, the purpose for which the monies held in trust are to be used and when the trust in

respect of that beneficiary is to terminate. Sometimes there is the stipulation that the trustee is to revert to the retirement fund in the event of any request for a capital distribution. The total investments of an umbrella trust are typically registered in the name of the umbrella trust only (and not in the name of each sub-trust). Some umbrella trusts have separate bank accounts in respect of each sub-trust whilst others do not.

14. The Trust Act has the following provisions which are material to umbrella trusts.

14.1. A trust is defined as follows –

“Trust” means the arrangement through which the ownership in property of one person is by virtue of a trust instrument made over or bequeathed –

- (a) to another person, the trustee, in whole or in part, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class of persons designated in the trust instrument or for the achievement of the object stated in the trust instrument; or
- (b) to the beneficiaries designated in the trust instrument, which property is placed under the control of another person, the trustee, to be administered or disposed of according to the provisions of the trust instrument for the benefit of the person or class or persons designated in the trust instrument or for the achievement of the objects stated in the trust instrument

but does not include the case where the property of another is to be administered by any person as executor, tutor or curator in terms of the provisions of the Administration of Estates Act, 1965.”

and

“Trust Instrument” means a written agreement or testamentary writing or a court order according to which a trust was created.”

14.2. In terms of section 4, a trust instrument is required to be lodged with the Master of the High Court before the trustee assumes control of the property to be administered in terms thereof.

14.3. In terms of section 6, a person may only act as trustee in terms of a trust instrument if authorised thereto in writing by the Master of the High Court. This section includes provisions relating to the furnishing of security as may be required by the Master.

14.4. In terms of section 9(1) –

“A trustee shall in the performance of his duties and the exercise of his powers act with the care, diligence and skill which can reasonably be expected of a person who manages the affairs of another.”

14.5. In terms of section 10, money received by a trustee must be kept in a separate bank account at a banking institution.

14.6. The Master has the power in terms of section 20 to remove a trustee in certain circumstances; and the Master may require a proper accounting by the trustee in terms of section 16.

- 14.7. There are no provisions in the Trust Act dealing specifically with how trustees are to be remunerated save that the remuneration to which a trustee is entitled must be "reasonable" (per section 22) and which may in the event of a dispute be fixed by the Master.
15. It is not easy to have a trust moved from one umbrella trust to another. Unless the beneficiary is prepared to make an application to the High Court it may not be easy to obtain the assistance of the Master. The fact that usually death benefits are placed in an umbrella trust without the consent of the beneficiary or his or her legal representative means that it is difficult for the trust in respect of that beneficiary to be moved to another trust.
16. There is no requirement in the Trust Act that a trust, including an umbrella trust, must be subject to annual audit.
17. It would be preferable for the Trust Act to make specific provision for umbrella trusts. The reason for this is that in my view there is a reasonable basis for construing each deed of settlement by a retirement fund in which conditions are imposed as a trust instrument as defined in the Trust Act.
18. The consequence of this is that such a deed of settlement must be registered as a separate trust with the Master of the High Court; separate letters of authority need to be issued by the Master of the High Court; a separate bank account must be opened in respect of that sub-trust and the assets of that sub-trust must be separately identified from the assets of the other sub-trusts. This has administrative, and therefore costing implications for an umbrella trust if these additional requirements must be adhered to.
19. As things stand the Master appears to have accepted that each sub-trust does not require separate registration, although apparently the South African Revenue Services does require each sub-trust to be registered as a separate tax payer.
20. It is unlikely that any beneficiary will dispute the current arrangement whereby each sub-trust is administered in terms of letters of authority granted in respect of the umbrella trust as a whole; but it is preferable that a contradictory situation should not exist whereby SARS considers each sub-trust to be a separate tax paying entity, but each sub-trust is not considered to be a separate trust by the Master of the High Court.
21. In my view the type of trust referred to in section 37C(2) of the PF Act can be either a bewind trust or a trust proper. A bewind trust is one in which the ownership of the assets of the trust vest in the beneficiary and the trustee manages those assets; whilst a trust proper is one in which the ownership of the assets of the trust vests in the trustee in his or her representative capacity.
22. Although section 37C does not, in my view, preclude any other person from also being a beneficiary from the trust or sub-trust to which the payment in terms of section 37C(2) is made if that trust or sub-trust has other assets, in my view it would be preferable that no other person, at least during the life time of the beneficiary of the death benefit, should be such a beneficiary. The reason for this is that ultimately the trustee must account to the beneficiary of that death benefit for the administration of that death benefit, and if that benefit is merged with other assets from other persons may benefit such an accounting may be difficult.
23. It is a fundamental principle of trust law that the trustee owes the beneficiary a fiduciary responsibility (see Honore's South African Law of Trusts, 5<sup>th</sup> Edition, 2002) and that accordingly the trustee must –

- 23.1. give effect to the trust instrument;
- 23.2. in the performance of his or her duties and the exercise of his or her powers, act “with the care diligence and skill which can reasonably be expected of a person who manages the affairs of another”; and
- 23.3. except as regards questions of law the trustee is bound to exercise an independent discretion.

(see Honoré, page 262).

- 24. From the above flow also the obligation to act in the best interests of the beneficiary and to provide an accounting of the administration (see Honoré, page 331). The fiduciary obligation also has implications in respect of secret profits and the issue of rebates which are currently the topic of discussion in the retirement fund industry (see further in this regard *Philips v Fieldstone (Pty) Ltd* (2004) 1 ALL SA 150 (SCA)).

### **FAIS ACT**

- 25. In terms of section 7(1) of the FAIS Act a person may not act or offer to act as a financial services provider (“FSP”) unless such a person has been licensed in terms of section 8.
- 26. In terms of section 1, an FSP is a person who as a regular feature of his or her business furnishes advice or renders an intermediary service or both. Typically most trustees do not render advice, as defined in the Act, as part of their function of acting as trustee; but the definition of “intermediary service” is so broad that it is possible for the responsibilities of a trustee to fall within that. This definition reads as follows –

““Intermediary Services” means, subject to sub-section (3)(b) (which is not relevant to the issue under discussion), any act other than the furnishing of advice, performed by a person for or on behalf of a client or product supplier –

(a) the result of which that a client may enter into, offers to enter into or enters into any transaction in respect of a financial product with a product supplier; or

(b) with a view to –

(i) buying, selling or otherwise dealing in (whether on a discretionary or non-discretionary basis), managing, administering, keeping in safe custody, maintaining or servicing a financial product purchased by a client from a product supplier or in which the client has invested;

(ii) ...

(iii) ...”.

- 27. The definition of “client” is so broad that, in my view, it is capable of including either a bewind trust or a trust proper. It reads as follows –

““Client” means a specific person or group of persons, excluding the general public, who is or may become the subject to whom a financial service is rendered intentionally, or is the successor in title of such person or the beneficiary of such service.”

28. Until 29 September 2004 it was not clear whether a person who acted as trustee was required to be licensed as an FSP under the Act. This issue was, however, clarified in Board Notice 97 of 2004 promulgated on 29 September 2004 in which the Registrar of Financial Services Providers stipulated that the trustee of an inter vivos trust (which includes an umbrella trust) was required to be licensed as a discretionary FSP with a partial exemption from the General Code and Code of Conduct for discretionary FSP's.
29. This partial exemption requires that where any reporting or disclosures have to be made by the trustee in terms of the FAIS Act and the beneficiaries are minors or under any other legal disability then such reporting or disclosures must be made to the curator, guardian or tutor of the beneficiary. Also where discretionary benefits are payable in terms of the trust then a financial needs analysis must be undertaken and financial products used which best suit the objectives, risk profile and needs of the beneficiary of the trust.
30. Both the general code and the code of conduct for discretionary FSP's contain onerous requirements, including compliance requirements which I will not set out here.
31. In terms of Government Notice 879 of 13 June 2003 promulgated in terms of the FAIS Act, an administrative FSP is required to have its assets held in the name of an independent nominee whose primary responsibility is to ensure that there is a proper reconciliation of the assets of the clients of that administrative FSP in the books of the latter. The function of an administrative FSP has similarities with that of an umbrella trust. This is relevant to the fact that in an umbrella trust there is no safeguard to ensure that a proper reconciliation of the assets of the umbrella trust as between each of its sub-trusts takes place.

### **UNCLAIMED BENEFITS**

32. The issue of unclaimed benefits in umbrella trusts is problematic.
33. Where the death benefit is paid to a bewind trust (where the beneficiary owns the trust assets, and the trustee administers those assets on behalf of the beneficiary) the issue is clear. This is governed by section 93 of the Estates Act which reads as follows –

“93. **Statements of certain unclaimed moneys to be published, and amounts unclaimed to be paid into Guardian's Fund.**

- (1) Every person carrying on business in the Republic shall in the month of January in each year prepare in the prescribed form and publish in the *Gazette* a detailed statement in respect of all amounts of R100 or more which were held by him or her or by any agent on his or her behalf in the Republic on the thirty-first day of December of the immediately preceding year and which were not his or her property or subject to any valid lien, but at the time of the preparation of the said statement have remained unclaimed for a period of five years or more by the rightful owners.
- (2) Any person who has prepared the said statement for publication, may deduct from the said amounts the cost of publication apportioned as far as possible among the owners.

- (3) After the expiration of three months from the date of publication of the said statement, such person shall forthwith transmit a statement and affidavit in the prescribed form to the Master and deposit in the Guardian's Fund to the credit of the rightful owners all such amounts still remaining unclaimed by the rightful owners."

34. It should be noted that the essential criterion for the application of section 93 of the Estates Act is that the trustee of the trust holds assets which does not belong to him or her personally and which have not been claimed by the rightful owner of those assets. If the trust in respect of a beneficiary is a bewind trust then, notwithstanding that the trustee has a fiduciary obligation to that beneficiary and must administer it until delivery to the beneficiary, the trustee is not the owner of that property since the ownership vests, as a function of being a bewind trust, in the beneficiary. Furthermore, the beneficiary acquires a right to claim delivery of the assets of the bewind trust from the moment the trust terminates.
35. The termination of the trust is either the date fixed in the trust deed (such as the age of majority of the beneficiary) or if the date of termination is at the discretion of the trustee, the date on which the trustee has resolved to terminate the trust.
36. The process in terms of section 93 of the Estates Act is that if a period of 5 years has by the 31<sup>st</sup> December of a particular year elapsed since the trust terminated, and during that period the assets of the trust have not been claimed by the beneficiary, then a statement of the amount due must be published in the Government Gazette. The costs of publication in the Government Gazette are payable from the assets of the trust, and 3 months after such publication in the Government Gazette the trustee must prepare an accounting and submit that, with an affidavit "in the prescribed form" to the Master together with a cheque for the amount of the assets of that trust so that the Master can credit it in the name of the beneficiary in the Guardian's Fund.
37. Notwithstanding the above, in my view it behoves the trustee because of the fiduciary obligation he or she has to the beneficiary, to take steps to trace the beneficiary and to that end to employ such tracing agents or other persons as may be necessary for that purpose. Naturally the costs of this are payable from the trust assets due to that beneficiary. The trustee should also, if possible, ascertain whether in fact the beneficiary has died (which I understand may be ascertainable if the beneficiary's identity number is known). All such efforts in tracing the beneficiary should be recorded in the affidavit accompanying the cheque payable to the Guardian's Fund which is ultimately payable in the circumstance referred to above. Of course, if it is ascertained that the beneficiary has died then the trust assets form part of his or her estate and must be delivered to the executor of that estate.
38. With regard to a trust proper the situation is different. The reason for this is that section 93 of the Estates Act applies to a bewind trust when it is terminated because the assets thereof are in law owned by the beneficiary even if not delivered to him or her. By contrast in a trust proper the assets are owned by the trustee in his or her representative capacity even once the trust proper has terminated until delivery of those trust assets to the beneficiary.
39. When a trust proper terminates and the assets of that trust devolve in terms of the trust upon the beneficiary, the beneficiary acquires a right to demand delivery of those assets. The right to such assets forms part of the estate of the beneficiary (whether deceased or insolvent) if such beneficiary dies or is sequestrated after the termination of the trust. However, the ownership of those assets does not pass to the beneficiary or the executor or trustee of his or her estate until those assets have been



delivered to the beneficiary or his or her executor or trustee. It follows that on a strict interpretation section 93 of the Estates Act does not apply to a trust proper.

40. The trustee of a trust proper is under the same obligation to trace the beneficiary or ascertain whether the beneficiary has died, with the costs thereof payable by the trust. If notwithstanding such attempts to trace the beneficiary he or she remains untraced, or it is ascertained that such beneficiary has died before termination of the trust and there are no substitute provisions which are of application, the assets of the trust which such beneficiary would otherwise have received either revert to the retirement fund or must be treated as abandoned property (*bona vacanta*). However, in the above situation the assets of the trust to which the beneficiary would be entitled in termination of the trust can only revert to the retirement fund if that trust could be said not to have intended to part permanently with any claim to that property. Whether such retirement fund would in fact have intended this will depend upon the circumstances, such as whether any conditions were attached to the death benefit payment. Property which is abandoned (*bona vacanta*) accrues to the State. In my view it is preferable that such property should not accrue to the State and accordingly any such unclaimed benefit should either revert to the retirement fund or to the fund to be established by the Registrar for unclaimed benefits.
41. I should mention that I have discussed the issue of untrained beneficiaries of an umbrella trust with an Assistant Master of the Master's Office in Cape Town. That Assistant Master has responsibility for the Guardian's Fund and I was advised that in respect of a trust property the Master would be prepared to take the view that section 93 of the Estates Act was of application so that there was no reversion of any unclaimed benefit to the State in the absence of that unclaimed benefit being capable of reverting to the trust.

## **CONCLUSION**

42. In my view the following are problematic legal issues in respect of umbrella funds receiving death benefits in terms of section 37C(2) of the PF Act –
  - 42.1. Some boards purport to impose terms and conditions on the trustee relating to the administration by that trustee of the death benefit. Unless the rules of the fund empower the board to impose such terms and conditions then those terms and conditions, to the extent that the effect is to vary any provisions in the umbrella trust deed itself, are of no force and effect. The trustee should not be placed in an invidious position if challenged by the beneficiary as to the legal efficacy of such terms and conditions.
  - 42.2. I have heard of the instance where a board establishes its own trust, without authority in terms of the rules of that fund, which that board administers as trustees. The establishment of such a trust could be challenged for the same reason as given in 41.1 above, and this is not desirable.
  - 42.3. Where the board imposes conditions relating to the administration by the trustee of a death benefit, whether within the powers of that board or not, this brings with it an obligation by the board to ensure that those conditions are adhered to. If the board does not ensure that those conditions are adhered to and the beneficiary in consequence suffers a loss, then the board may be liable for that loss. This is an unnecessary exposure to risk by that board. If the beneficiary does suffer a loss then the beneficiary must seek his or her recourse against the trustee.

- 42.4. Many boards have as a fixed policy the payment of any death benefit due to a minor being paid to a trust without regard for whether it would not be more appropriate either to make payment to the guardian of that minor or, if permissible in terms of the rules of that fund, to make payment in instalments.
  - 42.5. Some boards of retirement funds have a fixed arrangement with one umbrella trust to which all death benefits due to minors are paid without regard to the costs involved. There is no comparison with or an assessment of the different costs of other umbrella trusts.
  - 42.6. To the extent that a trustee administers any death benefit subject to conditions imposed by a board then it is possible that the Pension Fund Adjudicator may have jurisdiction in respect of any dispute regarding that administration in terms of section 30A of the PF Act. In my view it is not desirable for the Adjudicator to enjoy such jurisdiction.
  - 42.7. I have referred to the potential uncertainty in law regarding the status of a deed of settlement (see para 17 and following above). This is not a desirable state of affairs.
  - 42.8. The issue of unclaimed benefits in an umbrella trust is also problematic and should be resolved by statutory intervention.
43. Apart from the above, in my view the following should also apply to umbrella trusts –
- 43.1. every umbrella trust should be subject to annual audit;
  - 43.2. the same custodian arrangement, and responsibilities of such a custodian, as are found in the Code of Conduct for an administrative FSP in terms of the FAIS Act referred to in 31 above should apply;
  - 43.3. each sub-trust of an umbrella trust should have its own bank account number;
  - 43.4. it should be compulsory for the trustees and administrator of an umbrella trust to carry professional indemnity cover;
  - 43.5. it should be a requirement that any death benefit paid to an umbrella trust in respect of a beneficiary not under any form of legal disability should have the consent of that beneficiary, which consent should also cover any special terms relating to the administration of that benefit in the trust.
44. I would be happy to be of assistance if there is any aspect relating to umbrella funds which you may wish to deal with; but I suggest that you obtain some statistical and business information about the administration of umbrella trusts from an administrator of a large umbrella trust to provide some context for the legal issues.
45. I hope this is of some assistance.

Regards

**JONATHAN MORT**