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VOL.12

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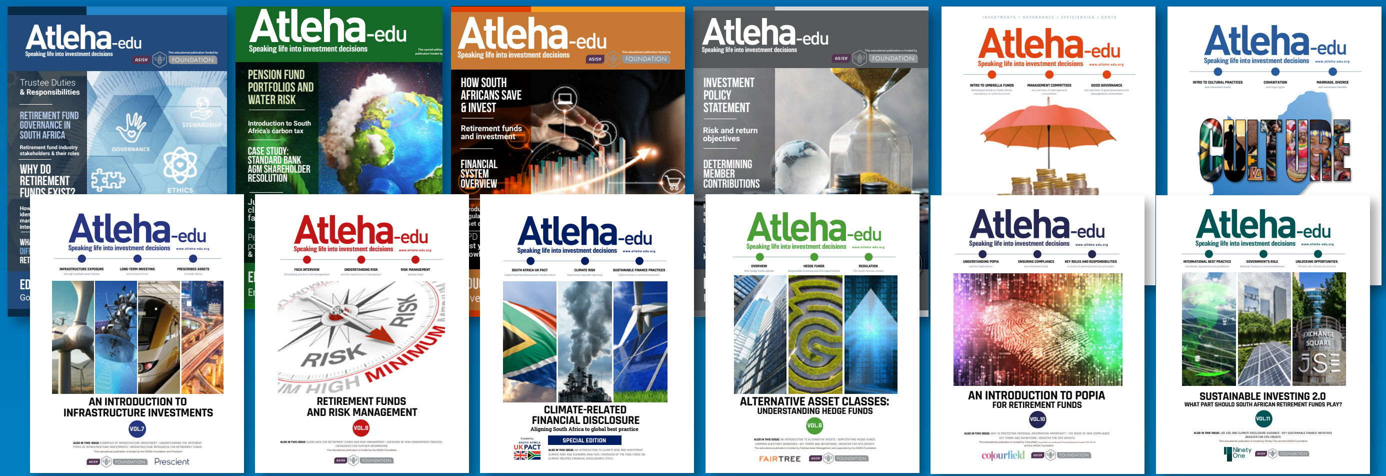

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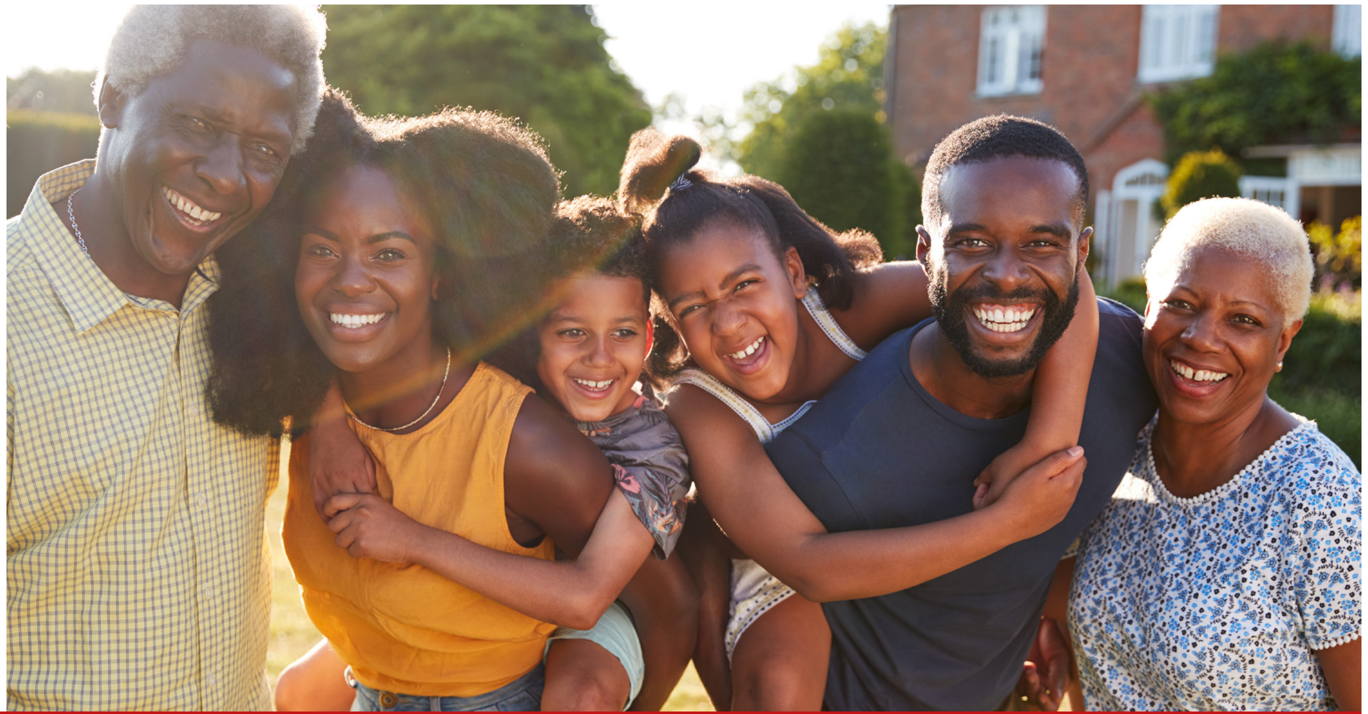

SECTION 37C OF THE PENSION FUNDS ACT AND ITS IMPLICATIONS

overview

Section 37C of the Pension Funds Act came into effect in August 1976. This section regulates the benefits payable upon the death of a member of a retirement fund. Ultimately, Section 37C places the onus on a fund's board of trustees in identifying and allocating these 'death benefits'. Starting with an overview of Section 37C, this article sets out trustees' responsibilities in the application of Section 37C of the Pension Funds Act.

Prior to the introduction of Section 37C into the Pension Funds Act, 1956 (herein referred to as 'the Act'), the benefit payable as a result of the death of a pension fund member would take place as set out in their last will and testament or according to the provisions of the laws of intestate succession.

Intestate succession

If you die without leaving a valid will, **your estate (all your assets left behind) will devolve** according to the Intestate Succession Act, 1987 (Act 81 of 1987). This means that your estate will be divided amongst your surviving spouse, children, parents or siblings according to a set formula.

The advent of Section 37C brought a statutory distribution regime which expressly excludes freedom of testation and rather looks to the board of a fund to distribute the death benefit.

Freedom of testation

Testators are given freedom to direct how their estate should devolve and free rein to dispose of their assets as they deem fit.

Why is it in place and how does it work?

Every retirement fund, registered in terms of the Act, is managed by a board of management commonly referred to as trustees. The trustees direct and manage the business of the fund and are consequently responsible for allocating retirement fund benefits that are payable on the death of a member in accordance with Section 37C of the Act.

Section 37C is applicable to all retirement funds, including pension, provident, preservation and retirement annuity funds. When a member of a retirement fund dies before reaching retirement age, the death benefit – which is the lump sum benefit that becomes payable – must be paid to the member's dependants and/or nominees. *(See 8 for more detail on dependants and nominees).* Distribution of the member's death benefits remains the responsibility of the fund trustees and they need to ensure that this is done fairly and equitably – meaning that the decision as to how the death benefit will ultimately be allocated and paid will be determined impartially and based on the relevant information that the trustees collected in order to effect a fair and equitable distribution of the death benefit.

The intention is to protect dependants, even over the clear wishes of the member. At its core the Act serves a social function, striving to ensure that no one who was financially dependent on the member is left without support.

THE EFFECTS OF SECTION 37C

Death benefits do not form part of the deceased estate of the member (other than in the limited exceptions set out in the section), but will be placed under the control of the relevant fund.

Death benefits are not subject to the law of marriages, which means it does not form part of the joint estate in the case of parties married in community of property.

The member's freedom of testation is limited – the trustees are not bound by the deceased's will or beneficiary nominations.

The law of intestate succession does not apply (where the member died without a valid will); death benefits are not subject to the law of marriages, and the common law (including law of contract) does not apply either.

SOURCES: MoneyMarketing | Sanlam

Death benefits are expressly excluded from the member's estate, and the benefit must be dealt with according to the Act. Therefore, the member cannot leave the death benefit to a specific person via the terms of their last will, and the executor of the member's estate does not deal with the payment of these death benefits except in specific circumstances as provided in the Act.

One of the objectives of Section 37C is to limit a member's freedom of testation in relation to benefits payable from their retirement fund in consequence of their death in order to protect financial dependency of dependants over the wishes of the deceased member as may be expressed in a valid nomination form or a last will and testament. Another objective of the section is to offer protection to dependants who do not reside in the same vicinity of the late member or the operations of the fund, which may make searching and finding dependants more difficult.

This latter objective is achieved by the placing of the death benefit under the control of the board of trustees to be dealt with in accordance with a **prescribed statutory scheme** of distribution. The statutory scheme of distribution also overrides a fund member's expression of wish as may be contained in a last will and testament or a beneficiary nomination form.

A statutory scheme means an elaborate and systematic plan of action on a particular topic provided in the statute itself. It can be a specific Act or legislation dealing with a particular subject.

As noted in *The legal obligations of retirement fund trustees in respect of Section 37C of the Pension Funds Act 24 of 1956* by Vanashree David:

"In line with the government's policy objectives to reduce potential dependency on itself, the Pension Funds Act expressly makes provision for the consideration of financial and legal dependency in the event of the death of a member of a pension fund arrangement. The intention being that the correct distribution of a death benefit will result in a lower risk that persons will have to recourse to the state for monetary social grants."

In other words, the rationale behind Section 37C is to ensure that those who were financially dependent on the member are not left destitute after their death. It also helps reduce the burden on the state by reducing the need for dependants to rely on social grants if they were supported financially by a member before their death. Furthermore, by saving for retirement, members receive significant tax concessions as incentive to provide for spouses, children and dependants in the event of the member's death.

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 retirement 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.

The death benefit is made up of the share of fund plus the insured risk benefit, commonly referred to as the 'approved risk portion' in most cases, whereas in some cases it is only the share of fund that will be payable by the fund.

A death benefit does not accrue if a member withdraws or retires from a fund and then dies before their withdrawal or retirement benefit is paid out. The benefit payable in terms of the rules will be paid into the estate of the member.

Some employers operate an unapproved lump sum death benefit scheme. Through practice, trustees often deal with unapproved death benefits as well. This is not allowed, as there is no provision in rules to do so.

Dependants versus nominees

Dependant: Spouses, children, parents, grandparents and grandchildren or anyone proven to have been financially dependent on the member at the time of their death and at the time of making payment; anyone entitled to maintenance; as well as anyone who may in the future have become financially dependent on the member.

Nominee: A nominee is any party (natural person, trust or legal entity) whose details the member provided to the retirement fund in writing indicating that they should be considered by the trustees for a possible allocation of the death benefit. Examples would be one or more dependants, or a person who is not a dependant, such as a friend of the member.

The different types of dependants, as well as the process of selecting a nominee, are discussed in further detail on p.8.

Trustees as the ultimate decision-makers

Section 37C places onerous duties on trustees in determining and ensuring the fair and equitable distribution of death benefits. The process – which is largely manual – can often be lengthy and cumbersome, leading to frustration on the part of the member's family, who may be in dire financial need.

In making a fair and equitable distribution of the death benefit, Section 37C imposes three principal duties on the board:

1. Identify and trace dependants (as defined in Section 1 of the Act) and those persons, if any, who have been nominated by the deceased member.
2. Make benefit allocations on a fair and equitable basis.
3. Determine an appropriate mode of payment of the death benefit.

In order to execute these duties, The Act requires the trustees to conduct an enquiry into the member's circle of dependants at the time of their death before deciding how the benefit will be allocated. The Act grants the trustees at least 12 months to search and find dependants, but the timeframe for allocating the benefit depends on the completeness and relevancy of the information provided, as well as the response time of the dependants and nominees.

In all instances, the trustees aim to distribute the death benefit as quickly as possible. However, the process can be challenging and timing depends on the complexity of individual circumstances and how long it takes to find all dependants.

Other factors can also influence the time taken to effect payment. For example, if the member dies through unnatural or undisclosed causes, the trustees may not be able to make any decisions or pay any benefits, until the official cause of death has been established by a state agency, or the police have confirmed that no one who is considered by the trustees to receive part of the benefit was involved in the member's death.

The statutory scheme of distribution of death benefits as contemplated in section 37C of the Act is very problematic for most boards of trustees and becomes increasingly so as our society moves away from the rigidity that previously defined the institution of marriage. The complexity of unique family units in South Africa makes the process of determining dependants difficult and subjective, as trustees are expected to balance the intended outcomes of the law with the compassion required to address the best interests of these unique family units, which may often be unfamiliar to a board of trustees.

In order to execute their duties under Section 37C properly, trustees require a basic and general understanding of the law of persons in South Africa in order to prepare them for their task. Fund trustees, death benefit subcommittees and human resource personnel require the necessary skills to discharge their onerous duties and responsibilities as contemplated in section 37C of the Act, where they are required to make findings of fact and law.

HOW DEATH BENEFITS ARE HANDLED

	Retirement funds	Life and savings products	Estate administration
Which Act applies?	• Pension Funds Act • Income Tax Act	• Long-term Insurance Act, 1998 • The Insurance Act, 2017 • Income Tax Act, 1962	Administration of Estates Act, 1965
How are the pay-outs determined?	According to Section 37C of the Act: distribution of death benefits	The conditions set out in the policy contract issued by the insurance/investment company	The provisions set out in the last will according to the Wills Act, 1953, or in accordance with the Intestate Succession Act, 1987, where there is no valid will
Who makes the decision regarding who will receive payment?	Board of trustees of the fund	The investor	The executor
Types of beneficiaries	Dependants (as defined by the Act) and nominees (as nominated by the member)	Beneficiaries appointed by the policyholder	Heir listed in the last will, where available, or family members according to the Intestate Succession Act
Typical timelines to payment	Trustees have up to 12 months to conduct their investigation	Once the death certificate and other documents have been received (typically about two weeks)	This will vary, depending on the complexity of the deceased estate

SOURCE: Adapted from Allan Gray

Complexities of Section 37C

As set out in this article, applying Section 37C of the Act is an onerous and complex process and the Act and its regulations offer little or no guidance to a board of trustees as to the application of very legally complex issues that may arise. While the intention of Section 37C was to streamline the distribution of benefits to ensure that no dependant is left destitute after a member's death, the outcome determined by trustees is not always met favourably – and the process of allocating death benefits can become drawn out and may sometimes be subject to protracted dispute resolution or litigation. Increasingly, disputes around the distribution of death benefits as determined by trustees are being brought to the Pension Funds Adjudicator to resolve. A person aggrieved by the outcome may approach the Financial Sector Tribunal or a high court.

In March 2020, the Financial Sector Conduct Authority (FSCA) published the *Interpretation Ruling 1 of 2020 (RF) on the Application of Section 37C of the Pension Funds Act, 1956.* This was in response to the consultation process around the fact that within the retirement fund industry there are differing practices on interpreting and applying Section 37C. "It is therefore important that there is clarity, consistency and certainty in the interpretation and application of this section," according to the FSCA.

A process is currently underway to provide suggestions and amendments for submission to the FSCA to address some of the complexities around the interpretation and application of Section 37C. Industry bodies, including Batseta, the Institute for Retirement Funds Africa (IRFA) and the Pension Lawyers Association (PLA) are collaborating in this regard, with the intention to make decision-making relating to death benefits easier for trustees, and reduce the number of decisions challenged in the forum of the Pension Funds Adjudicator.

The FSCA has acknowledged the industry's concerns:

"The Authority takes cognisance of the industry's proposal to amend Section 37C of the Act in order to provide greater clarity and simplify the death benefit distribution process. This is a more complex issue which requires careful consideration given its policy implications. In this regard, the Authority has already called upon key stakeholders to make submissions on possible amendments. The submissions are currently under consideration, and the Authority will also duly engage the National Treasury on this matter."

The articles in this educational publication will look at the duties imposed on trustees by Section 37C in more detail.

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DISTRIBUTION OF DEATH BENEFITS UNDER SECTION 37C OF THE PENSION FUNDS ACT

ASISA FOUNDATION

Section 37C of the Pension Funds Act, 1956 was promulgated in 1976 and is applicable to all retirement funds, including pension, provident, preservation and retirement annuity funds.

How does it work?

When a member of a retirement fund dies before reaching retirement age, the death benefit – which is the lump sum benefit that becomes payable – must be paid to the member's dependants and/or nominees. The advent of Section 37C brought a statutory distribution regime which expressly excludes freedom of testation and rather looks to the board of trustees of a fund to distribute the death benefit. In making a fair and equitable distribution of the death benefit, Section 37C imposes three principal duties on the board.

3 PRINCIPAL DUTIES IMPOSED ON THE BOARD OF TRUSTEES

1 Identify the dependants and the nominees of a deceased member

In order to disburse a death benefit, there is a duty on the board of trustees to conduct a proper investigation to determine all the dependants. The Act defines three categories of dependants:

- **Legal:** people who the deceased is legally obligated to provide support to (e.g. spouse and children – including children born out of wedlock and adopted children.)
- **Factual:** a person whom the deceased is not legally obligated to maintain but is, in the opinion of the trustees, factually dependent on the member for maintenance.
- **Future:** individuals for whom the deceased would have become legally obligated to provide maintenance had they not died.

Apart from dependants, members are able to nominate beneficiaries. Being nominated entitles the nominee to be considered by the trustees, but does not automatically entitle the nominee to a portion of the benefit.

2 Allocate distributions on a fair and equitable basis

Factors that the board should consider:

- The age of the parties;
- The relationship with the deceased;
- The extent of dependency;
- The wishes of the deceased placed either in the nomination forms completed during their lifetime and/or their last will; and
- The financial affairs of the dependants, including their future earning potential.

This basket of factors has been quoted with approval in various court cases regarding Section 37C matters. Other factors trustees should also take into account are other sources of income, such as the availability of social assistance grants and financial support available to the dependant, as well as the value of the death benefit that is available to allocate. Competing needs of the various dependants must also be identified.

3 Determine an appropriate method of payment of the death benefit

Trustees are required to effect payment within 12 months of the death of the deceased member to the dependants that they can find. However, if the board sees the need for further investigation, it is not compelled to make payment after 12 months have passed. Methods of payments are as follows:

1. Direct payment to a dependant;
2. Payment to a trustee of a trust so nominated by the member, the major beneficiary or a person recognised in law or appointed by the court to manage the affairs or meet the daily care needs of a beneficiary;
3. Payment to a registered beneficiary fund selected by trustees;
4. Payment in instalments.

Complexities

While Section 37C aims to ensure that those who were financially dependent on the member are not left destitute after their death, investigating the member's beneficiaries, dependants and nominees and identifying the best division of death benefit distributions can be a subjective process.

In order to execute their duties properly, trustees require a basic and general understanding of the law of persons in South Africa in order to prepare them for their task.

Further resources

PENSION FUNDS ACT (1956) | PF Circular 130 | OECD Guidelines for pension fund governance | FSCA Trustee Training Toolkit

SOURCES: ASISA Academy | Sanlam

IDENTIFYING AND TRACING DEPENDANTS

overview

Section 37C of the Pension Funds Act places a clear and onerous duty on the board of trustees to determine the fair and equitable distribution of death benefits of fund members. The first step is to find and identify dependants. This can be a complex process – and requires thorough investigation by trustees in order for the board to fulfil its fiduciary duties in terms of the Act.

Under Section 37C of the Pension Funds Act, distribution of the member's death benefits remains the responsibility of the fund trustees and they need to ensure that this is done fairly and equitably.

When a member of a retirement fund dies before reaching retirement age, the death benefit – which is the lump sum benefit that becomes payable – must be paid to the member's dependants and/or nominees in such proportions that the board may deem fit.

In order to disburse a death benefit, there is a duty on the board of trustees to conduct a proper investigation to determine all the dependants. Section 37C excludes freedom of testation and overrides the laws of intestate succession or any other law that may be in conflict with the statutory scheme contemplated in the section. This means that trustees can't simply follow the wishes of a member as expressed in their last will, or follow the beneficiary nomination made by the member during their lifetime or very often, dictates by family members that may have their origins in customary law or the common law. The board must establish who the persons are who fall within the ambit of "dependant" as defined in the Pension Funds Act, 1956 ('the Act').

Identifying dependants and nominees

Determining dependants and nominees can prove to be a challenging task for trustees, as they need to ensure that all dependants of the deceased member are taken into account in their decision-making processes. It is the duty of the board of trustees to correctly identify the members' dependants and nominees in order to ensure the equitable and fair distribution of the death benefit.

The Act defines three categories of dependants:

1. **Legal dependants:** This includes dependants in respect of whom the member owed a legal duty to support (meaning a duty that can be enforced in law), such as a spouse and children (including children born out of wedlock and adopted children). Parents, grandparents, grandchildren and siblings can fall into this category, subject to certain provisions. In order to fall within the ambit of this category, the person claiming will have to prove that the deceased was legally obligated, i.e. in terms of legislation (Maintenance Act, 1998, Divorce Act 1979, common law or a legal obligation) to maintain the person claiming.
2. **Factual dependants:** Those persons to whom the deceased owed no legal duty of financial support but who nevertheless factually depended on the deceased. This would include a spouse in respect of whom the marriage or union is not recognised by any law, or a financially independent major child. In order to fall within the ambit of this category one would have to prove that the deceased financially maintained you despite not having any legal obligation to do so, or where the legal duty to maintenance has ceased to exist.
3. **Future dependants:** Those persons whom the deceased did not financially maintain at the point of their death, but whom they would have maintained in future, had they not died. This would typically include elderly parents or a fiancé or an unborn child. In order to fall within the ambit of this category one would have to prove that the deceased would have become liable to maintain you, had they not died.

1 Legal dependants

- The spouse of the deceased
- Parents and children of the deceased
- Any children born out of wedlock
- Adopted children of the deceased
- Grandparents and grandchildren of the deceased
- Brothers and sisters of the deceased

2 Factual dependants

- Permanent life partners
- Same-sex partners whose union is not registered in terms of the Civil Unions Act, 2006
- Partners who are married according to the tenets of a religion

3 Future dependants

- The unborn child of a deceased member
- Person to whom the member was engaged to be married
- Parents, children and other legal dependants who may in future become in need of financial support

The following persons are not included in the definition of legal dependant:

- Step-children
- In-laws
- Nephews and nieces of the deceased

A complex process

As can be seen by the various categories of dependants set out in Section 37C, identifying and tracing potential dependants can prove to be a cumbersome process.

"This decision-making process is paper-heavy and requires a lot of manual input from various parties. In addition, each case is truly unique, depending on the individual circumstances of the affected family. Trustees are expected to act in good faith, apply their minds to the problem and exercise discretion after taking account of all the known facts."

SOURCE: Fedgroup Financial Services via *Mail & Guardian*

It is important to note that not all identified dependants automatically qualify to receive a portion or all of the death benefit. Once the board identifies a dependant as per the definition 'dependant' in the Act, such a dependant is only entitled to be considered by the board when making the benefit allocation decision. Nominated beneficiaries also do not have an automatic right to claim a death benefit. These distinctions are defined further in this article.

1. Legal dependants

Legal dependants are people who the deceased is **legally obligated** to provide maintenance and support to. The concept of maintenance is not defined in the Act. In terms of common law, maintenance includes basic life amenities, such as accommodation, food, clothing, education and medical care. This maintenance can only be enforced if:

- the **relative paying** the maintenance **has the means** to provide such support; and
- the **relative claiming** the maintenance **cannot support** themselves.

The legal obligation cannot be extended to nieces and nephews or in-laws of the deceased.

It is not necessary for the legal dependant to prove they were receiving financial support from the member, neither is it necessary for the deceased member to have paid such maintenance. Meeting the requirements above (member is able to provide support and dependant cannot support themselves) qualifies the dependant as a legal one.

In the case of parents needing support from their child, or grandparents or grandchildren or brothers and sisters needing financial support from a family member or the deceased, the common law indigency test must be conducted.

2. Factual dependants

A factual dependant is a person whom the deceased is not legally obligated to maintain but is, in the opinion of the trustees, factually financially dependent on the member for maintenance. Dependents under this category would need to prove that the financial support they received from the member was regular in nature and must show that the death of the member has caused some element of hardship (due to the financial support no longer being provided).

In the instance of an exclusive intimate permanent life partnership where both partners live together (cohabitation) and are contributors to a common household; own assets and property together; have joint bank accounts; and where the death of the member causes the surviving partner financial hardship, factual dependency may exist. This means trustees must consider the partner for a portion of the benefit.

3. Future dependants

Future dependants are individuals for whom the deceased would have become legally obligated to provide maintenance had they not died. This typically includes any unborn children of the deceased member; a person to whom the deceased was engaged to be married; as well as parents or children who are not financially independent at the time of the member's death but may, because of future circumstances, become in need of support.

Other considerations

Spouses of the deceased are eligible to be considered for the purposes of Section 37C. The term "spouse", as defined in Chapter 1 of the Act, is all-encompassing and includes the spouse, civil union partner and permanent life partner of the member – as well as a partner where the marriage was concluded in accordance with the tenets of a religion.

The Act does not offer any guidance to trustees on identifying a permanent life partner. However, there are some common factors for trustees to consider when making this decision and these include, not by way of limitation: the nature and length of the relationship, whether the partners lived together in a common household and the duration of

that cohabitation, how they conducted their finances (did they own property/assets together?). Essentially, in order to be deemed eligible to be considered by the trustees for a death benefit, the surviving partner has to prove, among other things, that they were in an intimate relationship of mutual dependence and ran a shared common household, or had children born from the relationship.

Spouses separated without a divorce having been obtained in terms of the Divorce Act, 1979, retain the rights of a married person, i.e. the partner will remain a spouse notwithstanding the separation. This means that if the rules of the retirement fund make provision for a spouse's pension upon the member's death, that spouse qualifies for the benefit.

An ex-spouse can be considered as a potential legal dependant if, upon the divorce, the spouse was awarded a right to receive maintenance from the deceased, irrespective of whether the deceased complied with such a maintenance order.

Nominated beneficiaries

Apart from dependants, members of retirement funds are able to nominate beneficiaries. A nominee is someone who cannot, under the Act, be defined as a dependant but has been nominated, in writing, by the member to receive their benefit or a portion thereof.

The member will fill out a nomination form, in which they will name all their financial dependants, as well as anyone else they wish to receive a portion of their pension benefits in the event of their death. The member specifies what percentage they wish each of their nominees to receive.

While the nomination form expresses the member's wishes, it is only one of the factors considered by the trustees as part of the process of making an equitable distribution – being nominated in a nomination form entitles the nominee to be considered by the trustees, but does not automatically entitle the nominee to a portion of the benefit. A nominated beneficiary will automatically receive a portion of the benefit if no dependants have been identified in the 12-month period following the death of a member and the nominee did not die before the member. The nominated beneficiary, unlike the dependant, does not need to prove their financial dependency on the member. A nominee qualifies by virtue of being nominated.

Categories of children

In some instances, there are issues regarding the paternity of a child considered as a beneficiary. In these cases, trustees must establish that there is, indeed a genuine dispute that cannot be resolved by any other means and must ensure that they find a means to resolve the dispute.

In the case of an adopted child, all obligations between children and biological parents are terminated and are transferred to the adoptive parents. This means that a member's adoptive children will be treated as one of their natural children when considered by the trustees. In the case of any foster children the deceased might have, the trustees need to determine whether the child is a factual dependant of the member.

Once all dependants have been identified, it is the duty of trustees to allocate and make benefit payments fairly, equitably and within in a reasonable timeframe. This is covered in more detail in the next article on p.11.

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ALLOCATING DEATH BENEFITS: EQUITABLE AND FAIR DISTRIBUTION

overview

Once trustees have identified dependants of a deceased member, the next step is to allocate and pay the death benefit. While Section 37C imposes this duty on trustees, there are no absolute or clear guidelines from the legislature or the regulator as to how to achieve an equitable distribution. Trustees therefore need to aim to be reasonable and fair with the information on hand. It is also advisable for trustees and administrators to keep a close eye on Pension Funds Adjudicator determinations in this regard for guidance on the application of Section 37C.

Section 37C grants trustees at least 12 months to search for dependants, but the timeframe for allocating benefits depends on the completeness of the information provided, as well as the response time of the dependants and nominees.

While trustees should aim to distribute the death benefit as quickly as possible, this process is influenced by individual circumstances and how long it takes to find dependants. Furthermore, the investigative process is labour-intensive and time consuming, as trustees have a fiduciary duty to investigate the circumstances of every possible dependant in order to establish financial dependency or otherwise.

This includes making direct contact (via email or telephone) with family members, colleagues, dependants friends, neighbours and any other third party that may assist with the investigation, gathering relevant information and supporting documents from the various stakeholders related to the death claim. An investigation by the trustees may sometimes dictate that the trustees should engage the services of a social worker to provide a report on the circumstances of a household or a specific dependant.

There is also the unfortunate reality that there are those that may make fraudulent representations and overstatements of their financial dependency upon a deceased member – further placing the onus on trustees to conduct thorough financial investigations and obtain supporting documentation from potential dependants. It is important for trustees to obtain corroborating statements from other people and not to rely on information provided in sworn affidavits without corroboration of the truthfulness of such information.

South Africa's socio-economic environment and familial structures can further complicate this process:

- A large proportion of our population engages predominantly in cash transactions, making it difficult to obtain the required paper trails for financial dependency supporting documentation.
- Communication with dependants residing in remote rural areas in South Africa and neighbouring countries may be difficult. Language barriers and the unavailability of translators can compound the problems trustees may face in the execution of their duties.
- Those who live in rural areas might not always have the means to obtain legal documentation and access to communication platforms to provide affidavits containing relevant information.
- Familial structures and extended family networks to whom some kind of financial support was provided can often include a large number of dependants, making the identification process complex and drawn out.

In this vein, it is important that trustees communicate with

beneficiaries throughout the information gathering process in order to help them understand the process and the prescriptions of the legislation. And, at all times, trustees must endeavour to be reasonable and fair in making decisions with the information they have.

Allocating the death benefit

Once the board has successfully identified all the dependants, the next stage of the enquiry would be to examine the financial needs of each dependant so that it can make an equitable financial distribution among them. In doing so, it has to consider all the relevant facts to the exclusion of irrelevant facts.

In the Pension Funds Adjudicator (PFA) determination of *Sithole v ICS Provident Fund and Another [2000] 4 BPLR 430 (PFA)*, the PFA summarised the factors that the board should consider when making their decision as to the allocation of the death benefit:

- The age of the parties;
- The relationship with the deceased;
- The extent of dependency;
- The wishes of the deceased placed either in the nomination forms completed during his/her lifetime and/or his/her last will; and
- The financial affairs of the dependants, including their future earning potential.

This basket of factors has been quoted with approval in various court cases regarding Section 37C matters. Other factors that trustees should also take into account are other sources of income, such as the availability of social assistance grants and financial support available to the dependant, as well as the value of the death benefit that is available to allocate. Competing needs of the various dependants must also be identified.

Section 37C caters for the following four scenarios – where the deceased is survived by: dependants only (no nominees); nominees only (no dependants); dependants and nominees; no dependants and no nominees. *(See graphic below for the allocation process based on these scenarios.)*

Section 37C of the Pension Funds Act sets out how the trustees must allocate the death benefit:

Only dependants

- If there are only dependants, the benefits will be distributed among these dependants at the discretion of the trustees.

Dependants & nominees

- If there are dependants and nominees, the benefits are distributed among these dependants and nominees at the discretion of the trustees.
- A nomination doesn't guarantee that the person will receive all, or a part, of the death benefit, as the trustees can't merely follow nominations. Likewise, they cannot lightly ignore the contents of a valid beneficiary nomination form without satisfactory justification.

Dependants not found, only nominees listed

- If no dependants are found and only nominees are listed, the trustees must establish whether or not the member's estate has enough money to pay its debts.
- If the estate is able to pay its debts, the benefit will be paid to the nominees in the proportions in which they were nominated. However, if the estate is insolvent (i.e. the value of the liabilities is more than the value of the assets), the death benefit must be used to pay the shortfall first and the remaining benefit (if any) will be paid to the nominees.
- The payment can only be made 12 months after the death, as this is the legal waiting period that is applied to give untraced dependants a chance to come forward.

No dependants or nominees

- If there are no dependants and no nominees, the trustees will pay the benefit to the member's estate after the 12-month waiting period.

The trustees may decide that it is fair to allocate a nil portion to specific dependants and/or nominees. All decisions are based on the unique merits of each claim.

SOURCE: Allan Gray

ALLOCATING DEATH BENEFITS:
DETERMINING APPROPRIATE METHODS OF PAYMENT

overview

Once the board of trustees has determined the beneficiaries and is satisfied that its proposed allocation is fair and equitable, the beneficiaries must elect how they would like to receive the death benefit.

The final duty of the trustees is to determine the most appropriate manner in which the benefits should be paid to the dependants and/or nominees, with there being a number of options available.

The trustees must inform beneficiaries of their decision, the reasons for reaching it and the portion of the benefit allocated subject at all times to the restrictions placed on them in terms of the Protection of Personal Information Act, 2013.

Payment options

Compulsory annuity	Lump sum	Combination
• The beneficiary can purchase a compulsory annuity (i.e. a living or guaranteed life annuity) in their name from a South African registered insurer of their choice.	• The beneficiary can take the full benefit as a lump sum (from which tax may be deducted).	• The beneficiary can take a combination of a cash lump sum (from which tax may be deducted) and a compulsory annuity.

If the beneficiary is a minor or legally incapacitated adult, the trustees may pay the benefit to a beneficiary fund or to the parent or other person who has a legal responsibility for that person, or to a care-giver as defined in the Childrens' Act, 2005. The benefit may also be paid to a trust, if nominated by the member or the beneficiary, and approved by the board of trustees.

SOURCE: Allan Gray

Payment timeframe

Section 37C(1)(b) aims to ensure that death benefits are distributed within a reasonable timeframe. According to Section 37C, the payment should be effected after a period of 12 months from the date of the member's death, at the least.

However, if the board sees the need for further investigation, it is not compelled to make payment after the 12 months have passed. Neither does Section 37C prohibit the distribution of death benefits within 12 months, nor does it compel distribution at the expiry of the 12-month period. The section 37C(1)(b) 12-month timeframe should serve as a benchmark that a board should strive to meet, but distribution should not be made if it has not taken all reasonable steps to identify dependants or is uncertain about dependants already identified. There may also be unavoidable delays in obtaining all relevant information.

If a board finds itself in the position where further investigation is needed, it should notify the identified beneficiaries of the need for further investigation. Communication with beneficiaries could guard against unwarranted costs that could arise from complaints being laid by dependants, as well as prevent any delay that could be caused due to dealing with a complaint brought to the Pension Funds Adjudicator (PFA).

Complaints and the Pension Funds Adjudicator

Dependants and nominees who wish to dispute trustees' decisions with regard to death benefit allocations and payments can do so by submitting a complaint to the principal officer of the fund. Should they wish to take the matter further – in the event that the principal officer's response is unsatisfactory – a complaint can be lodged with the PFA.

As discussed earlier in this publication, Section 37C imposes onerous duties on retirement fund trustees and, increasingly, complaints are being brought to the PFA. The retirement fund industry is engaging with the Financial Sector Conduct Authority in this regard.

The following article extract, which appeared in Death benefits and Section 37C: The burden on the board of trustees, published back in 2014 by Sanlam, still holds true:

"Section 37C must be carefully followed by the trustees, especially when it comes to determining when the duty to pay arises.... Boards would benefit if the legislature provided more specific guidelines, but for now, trustees and administrators should be mindful and pay close attention to PFA determinations as a form of guidance."

The next article on p.14 of this publication considers some of the concerns arising from the application and interpretation of Section 37C.

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NAVIGATING SECTION 37C: COMPLEXITIES AND CONCERNS

overview

In the absence of clear and specific guidelines around the application of Section 37C, the interpretation and application of this legislation can result in unintended outcomes – despite trustees' best efforts to make reasoned and fair determinations.

Boards beware: Pitfalls of an incorrect application of Section 37C
As has been set out in this publication, Section 37C imposes significant duties on the board of trustees: not only is the board tasked with conducting a proper investigation to determine all of the deceased member's dependants, it also has to make an equitable distribution of the death benefits.

Furthermore, Section 37C imposes all these duties on the board without providing any guidelines as to how they are to be achieved. Added to this responsibility, if the board fails to properly investigate all facts; fails to consider all the relevant factors; or takes irrelevant factors into account, the board's decision will be reviewable on the grounds that it exceeded its powers or that the decision constituted an improper exercise of its powers. At the same time, any failure by a board to take a decision timeously will be deemed as maladministration, potentially giving rise to a claim for losses or prejudice suffered by the benificiary.

The incorrect application of Section 37C will ultimately lead to the incorrect distribution of a death benefit. An incorrect distribution of a benefit could lead to numerous issues:

- **Prejudice of certain beneficiaries:** Where certain beneficiaries receive less than they should have, or are completely excluded from the distribution of benefits.
- **The unjust enrichment of a beneficiary:** Where a beneficiary receives more of a benefit than they should.
- **Loss by the fund itself:** Where the fund is unable to recover an incorrect payment already made.

In reality, any successful claim against a retirement fund for maladministration – if not borne by the members of the board – will ultimately be recovered from the fund (specifically other members of the fund).

Section 37C as a whole is therefore fraught with great difficulty in its application, and must be carefully followed by a board of trustees, especially when it comes to determining when the duty to pay arises.

As an example: In the matter of *Dobie NO v National Technikon Retirement Pension Fund [1999] 9 BPLR 29 (PFA)* the Pension Fund Adjudicator (PFA) considered the principle of *mora* or late payment interest, as well as the timeframes of Section 37C in great detail.

Ultimately, the PFA pointed out that the timeframes stipulated in Section 37C "have led to considerable debate and confusion in the pension funds industry and require clarification". The PFA also further noted that, "although the intention of the [Section 37C] legislature was noble, the problem with this section lies in its application".

Advice for trustees
Increasingly, disputes around the distribution of death benefits as determined by trustees are being brought to the PFA to resolve. While the intention of Section 37C was to streamline the distribution of benefits to ensure that no dependant is left destitute after a member's death, the outcome determined by trustees is not always well-received by dependants and nominees, and the process of allocating death benefits can become drawn out when disputes are lodged with either the fund and/or PFA or the Financial Sector Tribunal or the high court.

In order to mitigate this, a possible solution would be for the legislature itself to provide more specific guidelines (e.g., regarding the steps to be taken, what would be regarded as equitable, legal dependency, maintenance and indigency, etc.) and then allowing for a final distribution to known dependants and nominees at the expiry of a reasonable period (a type of prescription period), as well as clarity around what information can be provided to beneficiaries in terms of the Promotion of Administrative Justice Act, 2000, and the Protection of Personal Information Act, 2013 – concluding with the necessary indemnities to protect the board against further claims. At present, such guidelines are not yet in place and it is advisable for trustees and administrators to keep a close eye on PFA determinations and Financial Sector Tribunal reconsiderations and outcomes of high court cases in this regard for useful guidance on the application of Section 37C.

An academic critique of the constitutionality of Section 37C

Over and above the risk of having death benefit distributions disputed due to a lack of clear guidelines for trustees from the legislature or the regulator, there are also concerns around Section 37C's exclusion of freedom of testation, well-established in South African law. Section 37C overrides all other laws, whereby trustees are not obligated to follow a member's last will and testament in determining beneficiaries.

There is a need to protect vulnerable dependants, but not by giving trustees such broad, unguided powers to override members' wishes. I am therefore of the view that Section 37C is unconstitutional, insofar as it unreasonably and unjustifiably limits both the member's and surviving spouse's (married in community of property) rights to property and dignity. There have been a number of recent cases in which the courts, including the Constitutional Court, have acknowledged that testamentary freedom is protected by both the constitutional right to property and the right to dignity. The prevailing view within academic circles and the retirement fund industry is nevertheless that Section 37C is constitutional," - Dr Karin Lehmann, Department of Commercial Law, UCT

Dr Karin Lehmann, a lecturer at UCT's Department of Commercial Law, challenges Section 37C in her PhD thesis as being unconstitutional, given that most South Africans are deprived of their right to decide who will inherit their estate when they die. Section 37C does so by removing death benefits from one's estate and, therefore, from their testamentary control, and transfers the right and responsibility of allocating their death benefits to the trustees of retirement funds.

Lehmann argues that for most South Africans, the reality is that their retirement savings is the most valuable property they own when they die; and therefore, for most employed people, they are effectively denied the right to select the recipients of their most valuable asset – their retirement savings.

According to Lehmann, the reason members' wishes are so frequently overridden is attributable to the determinations handed down by the PFA. The PFA determinations have repeatedly emphasised that members' nomination forms are not binding on trustees, and that they serve as a guide only.

Apart from the effect that the Act has on members' testamentary freedom, its impact on spouses married in community of property can be equally devastating. It also takes away any right the surviving spouse would have had, under the law of marriage, to share in the death benefit. This is because Section 37C has been interpreted as superseding all other laws. Trustees often reallocate the benefit among dependants, so some dependants remain vulnerable, or even worse off, than would have been the case had the member's wishes been followed.

For example, where a member is survived by multiple dependants, or a combination of dependants and nominees, no dependant or nominee has a right to share in the benefit – whether and how much they ultimately receive depends on the discretion of the trustees. Although a member can nominate dependants, the term nominee is used to refer to nominated beneficiaries who do not qualify as dependants. This may happen because the member failed to complete a nomination form, perhaps believing that they had no dependants and that their death benefit would therefore be paid to their estate. It may also happen because the trustees overrode their wishes, which trustees frequently do in the course of determining the distribution of death benefits.

Lehmann believes her research will persuasively demonstrate that Section 37C is not constitutional and requires further reform. She also hopes to demonstrate that Section 37C too often operates inequitably in practice, given its impact on excluded beneficiaries.

The constitutionality of section 37C has not been tested in court and therefore trustees are required by statute to apply section 37C in its present form until the legislation is amended or the Constitutional Court has pronounced upon its constitutionality or otherwise.

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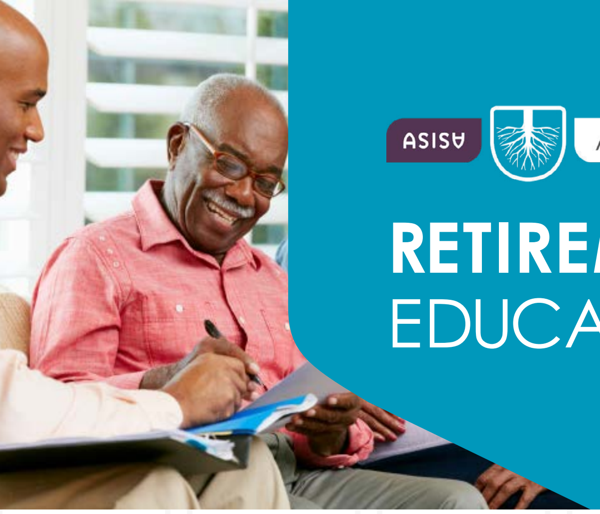

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Example question: Please choose the correct answer.

True or false? Under Section 37C of the Pension Funds Act, the law of intestate succession does not apply.

- [x] True
- [ ] False

1. Provide the correct answer. Section 37C of the Pension Funds Act is applicable to all retirement funds, including pension, provident, preservation and retirement annuity funds. In what year was this legislation promulgated?

----

2. True or false? A retirement fund member can leave a death benefit to a specific person via the terms of their last will.

- [ ] True
- [ ] False

3. Fill in the missing answer. In making a fair and equitable distribution of the death benefit, Section 37C imposes three principal duties on the board:

- Identify and trace dependants
- ____________________________
- Determine an appropriate method of payment of the death benefit

4. Name the three categories of dependants as set out in the definition 'dependant' in Chapter 1 of the Pension Funds Act.

1. ____________________
2 .____________________
3. ____________________

5. Select the incorrect answer. The following persons are **not** considered as legal dependants:

- [ ] Step-children
- [ ] Grandparents
- [ ] In-laws
- [ ] Nephews and nieces

6. True or false? A nominated beneficiary does not need to prove their financial dependency on the member.

- [ ] True
- [ ] False

7. Select the correct answer. Under Section 37C, how long are trustees given to search for dependants?

- [ ] 3 months
- [ ] 6 months
- [ ] 12 months
- [ ] 18 months

8. Fill in the missing words. If trustees cannot identify any dependants or nominees, the trustees will pay the benefit to the ______________ after the requisite waiting period.

9. True or false? The trustees may decide that it is fair to allocate a nil portion to specific dependants and/or nominees.

- [ ] True
- [ ] False

10. Name the office to which complaints can be lodged in terms of the Pension Funds Act.

____