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Pension Interest on Divorce and some frequently asked questions

One of the main assets in every employed person's estate is his pension fund interest. It is therefore not surprising that the reallocation of part of the pension fund interest to that member's (former) spouse in divorce proceedings is a common occurrence.

This publication will highlight some of the frequently asked questions that are raised when assessing the validity of a divorce order and whether or not the fund should comply with the order presented to the fund.

Summary

The history on the splitting of pension interest on divorce

The Divorce Amendment Act, 1989 provides that a party to a divorce action may share in the **pension interest** of the member of the Fund.

The Pension Funds Amendment Act, 2007 ("the PF Act"), introduced a "clean break approach" on divorce with effect from 13 September 2007. This allowed a non-member spouse to immediately claim a portion of the member's pension interest, in terms of an enforceable divorce order granted on or after 13 September 2007.

The Financial Services Laws General Amendment Act of 2008 ("the FSLG Act"), effective on 1 November 2008, then introduced the clean break principle retrospectively. This meant that all enforceable divorce orders, irrespective of when the order was granted, could be paid immediately to the non-member spouse.

Frequently asked questions?

1. What is pension interest and how is pension interest calculated?

Pension Interest is defined in the Divorce Act and for

- **pension and provident funds:** the value of the member's benefit in terms of the rules of the fund, if his membership to the fund would have been terminated on date of divorce on account of his resignation from office.
- **retirement annuity fund:** the total amount of the member's contributions to the fund up to the date of divorce, plus annual simple interest on those contributions, calculated at the prescribed rate of the interest (currently 15.5 per cent).
- **preservation funds:** equivalent portion of the benefit the member would have been entitled to in terms of the rules of the fund if his membership in the preservation fund was terminated on the date of divorce.

2. Can pension interest be claimed against post retirement products?

Pension interest cannot be claimed against a post retirement product such as a living annuity, annuity or a pension being paid from a fund. This is because the legislation requires pension interest to be calculated at the date of divorce whilst the member is a member of a fund. For post retirement products, the pensioner is no longer a member of the fund and there is no method of calculating the pension interest in terms of applicable legislation.



3. Does pension interest form part of the joint estate of the spouses?

There are conflicting court decisions on the treatment of divorce orders that provide for the division of the joint estate, insofar as pension interests are concerned and whether the pension interest falls automatically within the joint estate to be divided amongst the parties.

Comment: We are of the view that, whilst the Divorce Act does deem pension interest to fall within the estate of the spouses, it would not make the fund liable to make payment to the non-member spouse unless there is a court order specifically ordering the fund to make such payment. So the court order must comply with the requirements of (a) to (d) set out in 4 below.

4. What the requirements for a divorce order to be enforceable against a fund?

In terms of the Divorce Act, a divorce order should comply with the following in order to be binding on a fund to effect a deduction:

- (a) It must state the correct name of the fund concerned.
- (b) It must state that a portion of the member's pension interest in the fund be paid to the member's former spouse.
- (c) It must order that the fund's records be endorsed.
- (d) It must order the fund to pay the pension interest directly to the non-member spouse.

Comment: The question arises as to the validity of an order that does not specify that the amount shall be paid by the fund to the non-member spouse. The reason for this requirement is to create a direct link between the fund and the non-member spouse. Accordingly where the order does not order an endorsement, it is questionable whether a legal obligation has been created between the fund and the non-member spouse. In these circumstances the trustees would be well advised to require the non-member spouse to apply to court to amend the order. It is our view that a divorce order which does not order the fund to make payment to the non-member spouse does not comply with the Divorce Act.

5. Do same requirements apply to divorce orders granted post 13 September 2007?

The PF Act amended section 37D 4(a) which now provides that:

- the pension fund must be named in or identifiable from the order; and
- there must be an assigned amount.

Section 7(8) of the Divorce Act provides that the:

- pension interest must either be reflected as "due or assigned" to the other party;
- order must require that it "shall be paid by the fund to that other party when any pension benefits accrue in respect of the member";
- order must state that the court shall notify the fund concerned that an endorsement is to be made in the records of the fund.

It is clear that the PF Act has less stringent requirements, for example that the fund does not have to be correctly named but must be clearly identifiable. However the PF Act talks of a divorce order in terms of section of section 7(8) of the Divorce Act. This would imply that both the requirements of Divorce Act and the new requirements as set out in amended PF Act have to be complied with.

Comment: There are different views in the industry with respect to the divorce orders mentioning all of the requirements mentioned above. Some feel that the amendments to the PF Act have relaxed the obligation for divorce orders to meet all of the requirements as set out above.

Our view: is that where the divorce order is issued in terms of Section 7(7) and 7(8) of the Divorce Act, all the requirements mentioned in 4 above must be met. However if the order does not specifically mention the Divorce Act, the order will still be valid if the pension fund is named or clearly identifiable and an amount has been assigned to the non member spouse.



6. Where a fund has reviewed a divorce order and has indicated that the order not binding on the fund, what can the non member spouse do?

- The parties can apply to court to amend the divorce order so as to make it compliant with the requirements of the Divorce Act. However this is a time consuming and costly affair; or
- The member spouse may decide to settle the benefits due to his/her former spouse independently, in terms of an additional agreement between the parties which takes place outside of the fund, with such agreement having no impact on the fund.

7. An enforceable divorce order is presented to the fund. When must the fund pay the non-member spouse?

The amendments to the PF Act allow a fund to deduct a divorce award from the minimum individual reserve or from the member's benefit **immediately** following the divorce. The fund may only deduct a divorce amount after the pension interest has been reduced by any prior housing loan. This would mean that if the member has an existing housing loan only the balance, after the deduction of the housing loan, will be available to apply the divorce order. If there is a maintenance order and a divorce order presented to the fund, they must be deducted simultaneously. However, the maintenance order is given preference in the hierarchy of payments.

8. How is the payment of pension interest processed?

For divorce orders granted after 13 September 2007, the award of pension interest is deemed (for all purposes other than tax) to accrue to the member on the earlier of:

- the date of divorce; or
- on written submission of the court order by the non-member spouse on the funds named in the order or the funds to which it has been transferred.

For divorce orders granted prior to 13 September 2007, the award of pension interest is for the purposes of any law (except the Income Tax Act)

deemed to have accrued to the member on 13 September 2007.

The process for payment is set out hereunder:

Upon receipt of a valid divorce order, a fund has **45 court days** (a court day is any day other than a Saturday, Sunday or public holiday, and only Court days shall be included in the computation of any time expressed in days prescribed by any order of court) to request the non-member spouse to make an election as to how the benefit should be paid.

Comment: Although it is a contentious issue in the industry, it is recommended that the non-member spouse re-submit his or her divorce order, if it was previously submitted. It needs to be borne in mind that the duty to initiate the claim process should be placed on the non-member spouse so that the fund can fully comply with the time period prescribed by the Act.

The non-member spouse has **120 days** to make an election of how the benefit should be paid out. Once the non-member spouse has made his or her election in writing, the fund must deduct the award from the member's benefit. The non-member spouse may request payment, either

- in cash; or
- in the form of a transfer to another approved pension fund.

Comment: It is important to note that as a result of the changes to the Income Tax Act, a non-member spouse may now transfer their benefit to a preservation fund.

3. If a payment election is made the fund must transfer or pay the amount within **60 days**.
4. If no election is made the fund, after the expiry of the **120 days**, must pay it directly to the non-member spouse within **30 days**.
5. The non-member spouse is entitled to fund return from the expiry of the **120 day** period until date of payment.



9. Where the non-member spouse makes a request for the payment of interest, is any interest paid on the divorce benefit?

Yes, interest is payable. Where the order is a valid and enforceable against the fund, the fund needs to make payment. Interest will only be paid for the period exceeding 120 days from date of receiving the non-member spouse's election to date of payment of the benefit.

Comment: On expiry of the 120 days, the fund would disinvest the value of the benefit in terms of the divorce order and the money would be held in the fund's bank account until payment is made. Bank rate of interest will be paid for any period exceeding the initial 120 days. Any bank interest earned prior to the expiry of the 120 days would be credited to the member's fund credit. In terms of the current legislation, no interest is payable from the date of the divorce order to the date of receiving the payment instruction within the 120 days from the non-member spouse. Any returns that would be earned in this case would be credited to the member's current fund credit. It is therefore imperative that the non-member spouse notifies the fund soon after the divorce order was granted of his / her payment instructions.

If you need more information, please contact your consultant.
