Protection of Benefits

Long term insurance policies

Section 63 of the Long Term Insurance Act

This section deals with the protection of policy benefits provided under certain long term insurance policies in the event of the insolvency of the policyholder or the policyholder's estate.

The policies that are included under this section are assistance, disability, life and health policies. Sinking fund policies are not included under this protection.

Requirements for protection

The following requirements must be met for the protection to apply during the lifetime of the policyholder:

- The policy must be on the life of the policyholder or their spouse,
- The policy must be in force for at least 3 years.

The requirements to enjoy the protection upon the death of the policyholder include the following:

- The policy must be on the life of the policyholder or their spouse,
- The policy must be in force for at least 3 years,
- The policyholder is survived by a spouse, children, stepchildren or parents, and
- The policy benefits devolve upon them.

Where the requirements are met, in life and upon death, the protection of the policy benefits provided under this policy (or assets purchased <u>exclusively</u> with the policy benefits provided) will apply for 5 years from the date that the benefits were provided.

The protection will NOT apply if:

- The policy was ceded as collateral security in respect of a specific debt, or
- It can be shown that the policy was acquired to intentionally defraud creditors.

The burden of proof always lies with the person relying on the protection.

Example – protection in terms of section 63

Peter owns an endowment policy on his own life. The inception date was 1 April 2014. The maturity date is 1 April 2019. The beneficiaries on the policy are his two minor children.

Protection in the event of insolvency:

- If Peter became insolvent on 1 June 2017, the policy will be protected against his creditors as it is on his own life (policy is 3 years old).
- The protection would also apply if the policy was on the life of his spouse.
- The protection will not apply if the policy is on the life of one of his children.
- If Peter takes one loan or one withdrawal against the policy, this amount will be protected for a period of 5 years from date of payment.
- If Peter uses the withdrawal amount to purchase a new motor vehicle, this vehicle will be protected for the 5 year period.
- Assuming Peter is declared insolvent on 1 June 2019 and the policy was open-ended when it reached the contractual maturity date, the policy will still be protected against his creditors.
- Once this matured policy pays a benefit amount to Peter, the 5 year protection period will commence on date of payment.

Protection in the event of death:

- If Peter dies today, the policy will pay out to his minor children as a result of the beneficiary nomination and the benefit amount paid to them will be protected against Peter's creditors for a period of 5 years from the date of payment.
- The protection on death will also apply if the policy benefit was payable to his spouse or parents.
- The protection will also apply if the policy pays to Peter's estate and is paid to his spouse, child, stepchild or parent in terms of his will.

As it is required that the person enjoying the protection or that person's spouse is the life insured on the policy, it can be concluded that the protection is not available to non-natural persons.

Pieterse v Shrosbee (2004)

The court case resulted in a precedent that applies in the event of death of the insolvent policyholder. The Supreme Court of Appeal held that, in the event of the death of an insolvent policyholder, the trustee of that insolvent estate shall not have any claim on the policy proceeds where a policy is payable to a nominated beneficiary and that nominee accepts the benefit.

Note: Protection may not apply where it can be proven that the policy was taken out with the intent to defraud or prejudice the creditors.

Retirement funds

Section 37A of the Pension Funds Act

This section provides general protection in respect of pension benefits.

It may not be reduced, ceded, attached, pledged, executed, etc except as provided for in this Act or the Maintenance Act. Therefore, creditors may not attach the pension benefit except for:

- Deductions permitted in terms of the Pension Funds Act,
- Income tax in terms of the Second Schedule of the Income Tax Act or in respect of arrear taxes (IT88), and
- Judgment debt procedures – a maximum amount of R3 000 per annum may be taken into account for this order.

Section 37B of the Pension Funds Act

This section applies to the insolvent member during his lifetime. It protects pension benefits of a person who is sequestrated and determines that no such benefit may be attached by creditors – the Act refers to any benefit, which is interpreted to include the lump sum and the annuity income paid from a compulsory annuity.

Deductions in terms of section 37D

The fund is only allowed to make the following deductions against the member's benefit amount:

- Amounts due to SARS – arrear taxes;
- Where the fund allows for housing loans or guarantees, any amounts due to the fund in respect of the housing loan granted or guarantee given can be deducted –
    - from the benefit that the member or beneficiary becomes entitled to in terms of the rules of the fund, or
    - from the transfer amount where there is a transfer to another fund, if no reasonable alternative can be negotiated, and
    - in the event of the member defaulting on payment, the amount the member would have received on termination of membership on date of default. This is only as a last resort if no other alternative arrangement can be made.
- Where a housing loan or guarantee was granted by the employer and the member retires or ceases to be a member of the fund, the fund can deduct an amount from the benefit due to the member or beneficiary in favour of the employer.
- This amount is limited to the lump sum the member would have been entitled to in terms of the Second Schedule of the Income Tax Act.
- Any amount due by a member to his employer when the member retires or ceases to be a member of the fund as compensation for damages due to theft, dishonesty, fraud or misconduct, where the member admitted liability in writing or judgment was obtained.

- An employer is defined as an employer that participates in the fund and therefore this deduction cannot be made in case of a retirement annuity fund or a preservation fund.

- Amounts payable to a non-member spouse on divorce in terms of a valid court order, which is binding on the fund.

- Amounts payable in terms of a maintenance order, where that maintenance order is binding on the fund.

- Amounts the fund paid or will pay on behalf of the member or beneficiary, towards medical aid contributions, long-term insurance premiums or any other payment approved by the registrar.

In general the order of preference of claims is as follows:

- Tax on lump sums,
- Housing loans or guarantees,
- Maintenance orders,
- Divorce orders,
- Arrear taxes,
- Damages claimed by an employer,
- Judgment debt procedures.

Note: Deductions in respect of maintenance and divorce orders can be made whilst the person is still a member of the fund. All other deductions can only take place once membership is terminated and benefits accrue to the member.

Section 37C of the Pension Funds Act

In the case of the death of a member, the retirement benefit becomes payable to a dependent, nominee or the deceased estate (or a combination thereof).

The same deductions as discussed above will apply. The following rules apply in respect of the payment of death benefits:

- Firstly the trustees of the fund must ascertain, within twelve months of the member's death, who his dependants are, if any.

- They must then distribute the benefits amongst the dependants in a manner and proportion they deem fit and equitable according to the dependant's individual needs.

A dependant is defined as the spouse and children (regardless of age) of the member, any person the member is legally liable for maintenance, or was in fact dependent on the member for maintenance, or anybody in respect of whom the member would have become legally liable for maintenance, had the member not died.

- If there are dependants and nominated beneficiaries, the trustees may distribute the benefits between the dependants and nominees as they deem equitable.

- Where there are no dependants, but beneficiaries were nominated, the benefit must be paid to the nominated beneficiaries in accordance with the beneficiary nomination.

- If there are no dependants or beneficiaries, the benefit will be paid to the deceased estate, or if the deceased did not have an estate, into the Guardian's Fund or an unclaimed benefits fund.

Where there are dependants, the benefits will be protected against creditors, except for the deductions allowed for under section 37D. If there are no dependants or beneficiaries, the benefit will be paid to the estate and can be attached by creditors.

Where there is no dependant but a nominated beneficiary, creditors may benefit. In terms of section 37C, where the liabilities in the member's estate exceed his assets the trustees must firstly pay an amount to the deceased estate towards settlement of the liabilities. Only if there is a surplus, will it be payable to the beneficiary.

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