PLA Conference 2012

The Clean-break principle and public interest litigation

A. THE LEGISLATIVE HISTORY

1. Pre-divorce Act/Pension Funds Act

Prior to the amendment of the Divorce Act, 78 of 1979 ("the Divorce Act") by the Divorce Amendment Act 7 of 1989, a pension interest which had not yet accrued, such as an interest in a pension fund[1], was not regarded as an asset in the estate of a spouse.

After the amendment came into force on 1 August 1989, s7(7)(a) of the Divorce Act deemed a pension interest to be an asset in the spouse's estate for the purposes of determining patrimonial benefits.

In terms of s7(8)(a) of the Divorce Act, a court granting a decree of divorce could order that any part of a pension interest of a party to the divorce action may be assigned to the other party, and that part shall be paid by that fund to that other party 'when any pension benefits accrue in respect of that member'. The question of when accrual took place (which entitled the former spouse to payment of his/her share of the

[1] As opposed to an accrued benefit.

pension interest) depended on the rules of the particular fund but generally took place on retirement, resignation or some other exit event.

These amendments to the Divorce Act gave rise to various inequities highlighted in two reports of the South African Law Commission, dated March 1995 and June 1999. In the second report, the Commission expressed a preference for the promotion of the "clean-break" principle on divorce which allows the division of a pension interest on divorce and not later, that is, only when an exit event occurs.The Commission recognised that a non-member spouse is prejudiced if the value of his/her benefit is "frozen" at the date of divorce in that the non-member spouse could not benefit from any interest on or capital growth in his/her portion of the pension interest which, furthermore, could devalue substantially over time.

2. The Divorce Act/Pension Fund Amendments

The Commission's reports led to four sets of amendments to the PFA. First, there was the PFA Amendment Act 11 of 2007, by the introduction of new sub-sections to section 37D. These sub-sections

provided,amongst other things, that a registered fund may deduct from a member's benefit or minimum individual reserve, any amount assigned from his/her pension interest to a non-member spouse in terms of a decree granted under s7(8) of the Divorce Act. The PFA Amendment Act further provided that, for the purposes of s7(8)(a) of the Divorce Act, such pension benefit is deemed to accrue to the member, subject to certain provisos, on the date of the court order. One such proviso is that the non-member spouse has the option to elect that the assigned amount be paid directly to him or her or that it be transferred to an approved pension fund on his or her behalf.

The effect of the amendment was to change the date of accrual of the benefit of a non-member spouse. He or she no longer has to wait until an exit event took place since the benefit awarded to the non-member spouse in terms of the Divorce Act is deemed to have accrued on the date of the divorce order.

These amendments led to a number of problems, for example, in respect of the tax to be paid on the pension interest. These problems led to the second, third and fourth amendments.

None of the four sets of amendments to the PFA applied to funds such as the Government Employees Pension Fund. The situation was accordingly that the (non-member) spouse of a member of such a fund was treated differently from a (non-member) spouse of a member of a pension fund governed by the PFA.

3. The Government Employees Pension law

The Government Employees Pension law, proclamation 21 of 1996 (in particular section 21) precludes the Government Employees Pension Fund from applying the clean-break principle as is now provided for by section 37D of the PFA. This at least was the advice received by the responsible Minister (the Minister of Finance) and by the Government Employees Pension Fund.

A certain Ms Wiese, on her divorce from a member of the Government Employees Pension Fund found herself unable immediately to access the portion of her ex-husband's interest in the Government Employees Pension Fund. Instead she was told she would have to wait until her ex-husband exited the Fund.

Accordingly Ms Wiese brought an application in the High Court to declare the relevant provisions of the Government Employees Pension Law unconstitutional and invalid.

4. The Post Office Act

Similarly, the provisions of the Post Office Act (44 of 1958) precluded the Post Office Retirement Fund from applying the clean-break principle, as provided for in the PFA.

A certain Ms Ngewu found herself in a similar position to that of Ms Wiese. She too brought an application in the High Court but directed her attack against the rules of the Post Office Retirement Fund rather than against the provisions of the Post Office Act. This difference however was not material to the final outcome of her application.

B. POLICY CONSIDERATIONS

1. Equal Treatment

The irrationality and unfairness of the differentiation appears to have been recognised in influential government circles. On 23 February 2011 the National Treasury issued a public document entitled "A Safer Financial Sector to Serve South Africa Better". At page 36 of the document the following position is adopted by the National Treasury:

> "*Eighth proposal: Public entities and funds operating in the financial system should not be exempted from general legislation and regulatory standards that apply to the private sector institutions and funds. Where there are exemptions, they should be transparent, and subject to review on a regular basis.*
>
> *Many public pension funds (such as the Government Employees Pension Fund, Transnet Pension Fund, and Municipal Pension Fund) are exempted from the Pension Funds Act, and often they have their own legislation. …. Public financial institutions or funds should not be exempted from general laws and the ambit of regulations as these exemptions risk undermining the integrity of the regulatory system, and also create the false impression that the*

standards applied to public entities are less rigid than those applied to the private sector."

At pages 56 – 57 it is stated:

"*Public sector pension funds (such as those of state-owned entities, the Government Employees Pension fund or GEPF and local government pensions) are characterised by fragmented rules and supervision for example the largest pension scheme in the country, the Government Employees Pension Fund, is self-regulated and has different rules compared to other public sector pension funds. This is the case with many other government pension schemes. Although the Pension funds Act ("PFA") is a relatively old piece of legislation, having been enacted in 1956, and in need of modernising, it has managed to keep pace with certain key developments. For example the PFA:*

- *Allows divorcees to immediately receive a share of their member-spouse pension upon divorce (if the benefit is prescribed by the marriage contract), and not wait for the member-spouse to first retire. A number of public sector pension funds do not*

incorporate these modern rules, and therefore place their members at a disadvantage."

2. Preservation Principle

There are of course sound arguments why pension fund members and their former spouses should not be permitted to withdraw pension benefits – the so-called "preservation principle" – but, given that the "clean-break" principle is now applied to the divorced spouses of private pension fund members, there appears to be no rational reason why this should be withheld from their counterparts on divorce from a member of the fund (or any other public pension fund, for that matter).

The South African Law Commission report on the sharing of pension benefits dated June 1999 recommended in summary:

"Any share of retirement fund benefits to which a "non-member spouse is entitled is made available on a locked-in basis – in other words, by way of a deferred pension and not as a cash benefit.

3. Hardships Suffered on Divorce

In the case where a non-member spouse only became entitled to her share of the pension benefit when the member retired or otherwise terminated his membership, the non-member spouse suffered several disadvantages.

Amongst these were the fact that the non-member was not entitled to interest in respect of her share. Nor was she entitled to returns earned by the relevant fund on its investment during the period from the date of the divorce to the date on which it was paid to her. Her value accordingly reduced during that interim period.

The prejudice arising out of this differentiation is obvious. The former class of persons can gain immediate access to their share of their former spouse's pension interest, and can obtain an immediate cash payment in respect thereof or transfer such benefit to another pension fund. By contrast, the divorced spouse of a member of the Fund (and other funds not governed by the PFA) can only gain access to his/her share of a former spouse's pension fund interest when

an exit event occurs which, of course, may be many years away. During that period the divorced spouse is denied the benefits of any growth in his/her share of the pension interest.

4. Financial Prejudice Suffered by Non-member Spouse

Whilst it is conceivable that a settlement agreement or court order concluded on divorce may alleviate such prejudice by various means, for example, by increasing the divorced spouse's share of the pension interest or awarding compensation out of other assets, such measures do no more than mitigate the inequity in some cases. This is not least because the timing of the exit event will often not be known and because in certain cases the pension interest may be the only significant asset, thus leaving little room for alternative compensation. In any event, as was held in *Van der Merwe*[2], the constitutional validity or otherwise of legislation does not derive from the personal choice, preference, subjective consideration or other conduct of the person affected by the law.

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2 Van der Merwe v Road Accident Fund 2006 (4) SA 230 (CC).

C. JUDGMENT OF BOZALEK J (WIESE)

1. Reasoning

Ms Wieseis the former spouse of a member of the Government Employees Pension Fund. In March 2008, in terms of a settlement agreement which formed part of a divorce decree, she was awarded a 25% share of her spouse's pension interest in the Fund. She had been unable to realise this interest, however, since the legislation governing the Fund, unlike that governing private pension funds, only allowed for the realisation of such an interest as and when an "exit event" took place in relation to the former spouse, such as resignation, termination of employment or death, and no such event has occurred.

Ms Wiese alleged financial hardship and stated that she had unsuccessfully sought to realise her share of her former spouse's pension interest in the fund. Having exhausted all other avenues she sought an order that the governing legislation, the Government Employees Pension Law, Proclamation 21 of 1996, ("the law") was inconsistent with s9(1) of the Constitution of South Africa and was invalid to that extent. She also

soughtan order whereby, broadly speaking, certain provisions in the Pension Funds Act 24 of 1956, ("the PFA") which allow for the immediate realisation of pension benefits awarded on divorce to the non-member spouses of members of private pension funds, be read into the "Law".

Ms Wiese's case was that this differential treatment of a non-member spouse of a Fund member from that of a non-member spouse of a member of a pension fund governed by the PFA, violated the affected party's right, in terms of s9(1) of the Constitution, to the equal protection and benefit of the law. More particularly, it was contended that her right of access to social security as entrenched in s27(1)(c) of the Constitution, and that of others in her position, was violated.

It was common cause between the parties that the provisions of the Law, more particularly s21 thereof, precluded the Fund from applying the "clean-break" principle as is provided for by s37D(1)(d) of the PFA. At the very least the Minister and the Fund have been advised that this is the position and appears to have accepted such advice.

Testing the constitutionality of the Law, namely the Government Employees Pension Law, Proclamation 21 of 1996, required the application of the well-known testfor a violation of the right to equality, first enunciated by the Constitutional Court in *Harksen v Lane N.O. and Others* 1998(1) SA 300 (CC) as follows at para 53:

> *"(a) Does the provision differentiate between or categories of people? If so, does the differentiation bear a rational connection to a legitimate government purpose? If it does not then there is a violation of s8(1). Even if it does bear a rational connection, it might nevertheless amount to discrimination."*

Assuming the differentiation passes the first test, namely, that of showing a rational connection to a legitimate government purpose, the court embarks upon a two stage analysis to determine whether the differentiation amounts to discrimination. This involves, firstly, establishing whether the differentiation amounts to unfair discrimination and if so, whether the provision can be justified under the limitations clause.

The first leg of the equality test thus determines whether the State, through the impugned legislation, is acting in a rational manner. As was said of the state in *Prinsloo v Van Der Linde and Another* 1997(3) SA 1012 (CC) at para 25:

> "*It should not regulate in an arbitrary manner or manifest "naked preferences" that serve no legitimate governmental purpose, for that would be inconsistent with the rule of law and the fundamental premises of the constitutional State. The purpose of this aspect of equality is, therefore, to ensure that the State is bound to function in a rational manner. This has been said to promote the need for governmental action to relate to a defensible vision of the public good, as well as to enhance the coherence and integrity of legislation."*

In the Wiese matter it was clear to the court that the differentiation was between non-member spouses of funds governed by the PFA ("private pension funds") and non-member spouses of members of the Fund (and other pension funds not governed by the PFA). The differentiation arose out of the legislature's failure to apply the "clean-break" principle on divorce to the

latter class of persons. Neither the Fund nor the Minister sought to contend that the differentiation in question BORE a rational connection to a legitimate government purposes. None was apparent to the court.

The court recognized that there were sound arguments why pension fund members and their former spouses should not be permitted to withdraw pension benefits – the so-called “preservation principle” – but, given that the “clean-break” principle was now applied to the divorced spouses of private pension fund members, there appeared to be no rational reason why this should be withheld from their counterparts on divorce from a member of the fund (or any other public pension fund, for that matter).

In the absence of any purpose being proffered by the Fund or the Minister to validate the impugned provision, and in the light of their concessions regarding the unconstitutionality of the differentiation, the court felt it unnecessary to embark on a justification enquiry.

In the result the court was satisfied that the failure of the Law to provide for the application of the “clean-break” principle rendered it, to that extent, inconsistent with s9(1) of the Constitution inasmuch as it sanctioned unequal treatment or differentiation of a class of persons, which differentiation bore no rational connection to a legitimate government purpose. Accordingly Ms Wiesewas held to be entitled to a declaration of constitutional invalidity and an appropriate remedy.

To all intents and purposes the Fund and the relevant Minister had conceded that the applicant’s right to the equal protection and benefit of the law was breached by the differential impact of the relevant legislation on non-member spouses of members of private pension funds and the Fund. Where the parties differed however was in regard to what remedy should be afforded Ms Wiese.

2. Remedy

In Wiese the reading-in remedy was opposed by the Fund: firstly on the ground that it had already been engaging with the Minister regarding an amendment to

the Law and it would thus be inappropriate for the Court to intervene where steps are being taken with a view to amending the relevant legislation; and secondly, since a reading-in is in its nature a temporary remedy, and in view of indications that various changes may well be made to the pension dispensation as a whole, including the Law, it would be inappropriate to grant such a remedy only for the Fund to be subjected in due course to additional changes in this area.

The court took various factors into account, but most notably the indications that a process of overall legislative review and reform may be imminent and the far-reaching nature of the proposed reading-in, the court came to the conclusion that granting an immediate reading-in remedy would be inappropriate. It considered instead that it would be just and equitable to suspend the declaration of invalidity and leave the precise nature of the remedial provisions to the legislature. However the court made provision for a default order remedying the constitutional defect in the event that Parliament did not do so timeously.[3]

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[3] Such an order was made by the Constitutional Court in *Minister of Home Affairs and Another v Fourie and Another (Doctors for Life International and Others, Amici Curiae) Lesbian and Gay Equality Project and Others v Minister of Home Affairs and Others* 2006(1) SA 524 (CC).

On behalf of the Minister and the Fund it was contended that Parliament should be granted 18 months to correct the defect. However, a theme of the Minister's reply to Ms Wiese's challenge was that his department was already engaged in a process of legislative review in this area. Furthermore, that department had been, by its own admission, aware of the problem for some time. In the circumstances, and taking into account that any time limit would only commence once the Constitutional Court pronounced on this matter, the court considered that a period of 12 months within which the constitutional defect should be remedied would be adequate.

D. SOME PROBLEMS UPON IMPLEMENTATION

1. Tax

These are complex issues and I am not fully conversant with the series of amendments and proposed amendments to the tax laws. The issue in essence is who should pay the tax on the non-member spouse's resultant pay-out and when.

2. Financial Considerations for the Affected Pension Fund

In Wiese, the Minister's objections to the reading-in remedy focussed on the policy-laden choices which were involved in remedying the constitutional defect. The Minister argued that there were are much better left to the legislature to grapple with, rather than such choices being usurped by the Court, particularly where reading-in was likely to be only a temporary measure.

These policy choices or issues included the calculation of the remaining benefit due to the member if the non-member's share was deducted before the former is due. The court felt that Parliament might wish to prescribe how such remaining benefit is to be calculated rather than leave this to the Fund's Board, given that the Fund was a public fund, relying on the fiscus and catering for public servants. The problem is more complex where a defined benefit fund is concerned.

Yet a further policy issue is to what extent any revisionary measure should be retrospective, taking into account that affected parties may have made compensatory arrangements in settlement agreements,

thereby raising the possibility of a non-member spouse benefitting twice.

E. SOME FUTURE CONSIDERATIONS

1. Public Interest Litigation

Of some interest to public interest lawyers is the fact that, quite obviously, individuals in the position of Ms Wiese would not have had the resources to embark upon complex and lengthy litigation. This role was fulfilled admirably on Ms Wiese's behalf and on Ms Ngewu's behalf in the matter involving the Post Office, by public interest bodies.

Wherever legislation is wanting in relation to the lawful and fair treatment of members of pension funds or wherever funds themselves are found wanting it can be expected that applicants, supported by public interest entities, will once again step in to the breach.

2. Other Funds

The Wiese application has been followed by an application by one Ms Ngewu against the Post Office

Retirement Fund and the Minister of Communications. The complaint is similar but the remedy sought is different in the sense that the attack is on the pension fund rules rather than on the governing legislation.

However a draft Bill amending the legislation (hopefully to the satisfaction of Ms Ngewu and her advisors) will be put before Parliament this year. The matter, due to be heard before the Constitutional Court tomorrow, has been postponed into 2013.

In addition to these funds there are, as I have said, other funds which also do not apply the clean-break principle. These are the Municipal Pension Fund and other funds of state identities.

I am reliably informed that the next fund to become the subject to litigation (following Wiese and Ngewu), is the Transnet Pension Fund.

3. Preservation Principle

Reforming pensions to increase savings

In relation to the size of the economy, South Africa has one of the largest pension fund industries in the world, with nine million members and assets in excess of R2 trillion. Globally and locally, pension funds are also important institutional investors. They pool funds from both employers and employees, with the aim of providing retirees and their beneficiaries with income upon the retirement, death or disability of a member. This guards against poverty in old age and reduces the potential dependency on the government.

The Old Mutual Savings Monitor (2010) ranks pension funds as the second most widely used savings vehicle after funeral policies in South Africa.

Preservation is the requirement that money saved for retirement through a pension, provident or retirement annuity fund should remain in such a fund or be rolled over into another similar savings vehicle without incurring taxes or penalties until the person retires in the normal course of his or her career, reaches the age of 55 or retires on grounds of permanent disability.

According to the Monitor, 52 per cent of 91 survey respondents who changed employers and exited their

funds withdrew benefits in cash, 25 per cent transferred their benefits to the fund of the prospective employer, 18 per cent left the benefits in their previous fund, 3 per cent invested in a retirement annuity fund, and 4 per cent in a preservation fund. Further, Anderson (2010) states that following the retrenchments that took place between January 2009 and August 2010, only 10.2 per cent preserved while 89.8 per cent took cash pay-outs[4].

The large withdrawals from the pension fund system could be triggered by various factors including financial hardship, retrenchments and indebtedness. Moreover, the current default system makes it easier for persons who might not even be going through financial hardship to withdraw their savings, simply because the current system does *not* compel preservation of retirement savings upon job changes, retrenchment or divorce. The Income Tax Act does encourage preservation to some extent, by allowing retirement capital to be transferred tax free to a similar approved fund, while taxing any pre-retirement withdrawals. The challenge with the current tax system is that the tax clearly does not serve as a strong disincentive since people are willing to pay it and withdraw their savings.

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4 John Anderson, *Are we saving enough?*Presentation at the Institute of Retirement Funds 2010 Conference on Retirement Funds.

The introduction of mandatory preservation is therefore critical and National Treasury plans to extensively consult all relevant stakeholders.

Further, to effectively enable this change, there should also be an enhanced system of portability. Portability refers to a worker's ability to maintain or transfer accumulated pension benefits either to a preservation fund or a prospective employer's plan when changing jobs, for example. This would introduce additional competition in the industry and possibly lead to a fall in costs.