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Living Annuities at divorce – The impact of the Montanari judgement

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Introduction

The treatment of living annuities (and resultant annuity income payments) at divorce has been a contentious point of law for years. A recent Supreme Court of Appeal judgement has shed a new light on the treatment of an annuitant's *right to future income payments* for purposes of calculating accrual. In this edition we will assess the impact of this judgment on the future treatment of living annuity income payments at divorce.

The Divorce Act No. 70 of 1979

Section 7(7) of the Divorce Act No. 70 of 1979 ("the Act") provides that a "*pension interest*" as defined in section 1 will be deemed to be a part of the assets at divorce:

> *"7) a) In the determination of the patrimonial benefits to which the parties to any divorce action may be entitled, the pension interest of a party shall, subject to paragraphs (b) and (c), be deemed to be part of his assets"*
>
> (my emphasis)

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Section 7(8) of the Act goes on to state that:

> *"Notwithstanding the provisions of any other law or of the rules of any pension fund –*
>
> *(a) the court granting a decree of divorce in respect of a member of such a fund, may make an order that-*
>
> *(i) any part of the pension interest of that member which, by virtue of subsection (7), is due or assigned to the other party to the divorce action concerned, shall be paid by that fund to that other party when any pension benefits accrue in respect of that member;*
> *(ii) the registrar of the court in question forthwith notify the fund concerned that an endorsement be made in the records of that fund that that part of the pension interest concerned is so payable to that other party and that the administrator of the pension fund furnish proof of such endorsement to the registrar, in writing, within one month of receipt of such notification…'*
>
> *(my emphasis)*

If one looks at the wording of section 7(7) and 7(8) it is clear that the non-member spouse is only entitled to a portion of the member spouse's notional benefit if it qualifies as "*pension interest*" as defined. **It is therefore important that one understands what is meant by "*pension interest*".**

"*Pension interest*" is defined in section 1 of the Act as referring to the benefits to which such member would have been entitled in terms of the rules of the fund if his membership of the fund would have been terminated on the date of the divorce on account of his resignation from his office. Simply put: it refers to a notional benefit that would have been payable to the member spouse had his membership terminated at the date of divorce.

What this basically means is that the member spouse *must still hold a pension interest in the fund as at the date of divorce*. If a resignation benefit had already become payable to him *before* the divorce, he could not again be deemed to become entitled to a resignation benefit at the date of divorce. He would therefore no longer have a "*pension interest*" for the purposes of sections 7(7) and 7(8) of the Act.

Living Annuities

At retirement, a member of a retirement fund (excluding a provident fund) is entitled to withdraw up to a maximum of one-third of the underlying fund value as a lump sum. A minimum of two–thirds of this value must be used to buy a ***compulsory annuity***. This compulsory annuity can be provided by the retirement fund or, alternatively, the retirement fund can transfer the obligation to provide an annuity to a registered insurer. In terms of the arrangement with the insurer, the insurer undertakes to provide an annuity income to the former member.

The annuity to be provided may, depending on the former member's election, either be a conventional annuity or a *living annuity* as defined in section 1 of the Income tax Act 58 of 1962.

Section 1 of the Income Tax Act defines a living annuity as follows:

"living annuity"

means a right of a member or former member of a pension fund, pension preservation fund, provident fund, provident preservation fund or retirement annuity fund, or his or her dependant or nominee, or any subsequent nominee, to an annuity purchased from a person or provided by that fund on or after the retirement date of that member or former member in respect of which—

a) the value of the annuity is determined solely by reference to the value of assets which are specified in the annuity agreement and are held for purposes of providing the annuity;
b) the amount of the annuity is determined in accordance with a method or formula prescribed by the Minister by notice in the Gazette;
c) the full remaining value of the assets contemplated in paragraph (a) may be paid as a lump sum when the value of those assets become at any time less than an amount prescribed by the Minister by notice in the Gazette;
d) the amount of the annuity is not guaranteed by that person or fund;
e) on the death of the member or former member, the value of the assets referred to in paragraph (a) may be paid to a nominee of the member or former member as an annuity or lump sum, or, in the absence of a nominee, to the deceased's estate as a lump sum; and
f) further requirements regarding the annuity may be prescribed by the Minister by notice in the Gazette;

(my emphasis)

Divorce after retirement

When looking at the above, it is clear that a *living annuity* does not fall within the definition of a "*pension interest*" as referred to in the Act. The ex-spouse therefore cannot claim against the living annuity as part of the former member's "*pension interest*" and, as such, no pay-out can be made.

Sadly, it often happens that divorces are finalised long after the former member spouse has already retired and purchased (for example) a living annuity. In this instance, any divorce order attempting to allocate all or a portion of a spouse's living annuity to the other spouse will be unenforceable. For the reasons as explained in detail above, a divorce court is not empowered to make an order in terms of section 7(8) of the Act in respect of a living annuity and any such order would not be binding.

What is equally important to understand is the **legal nature of this product**:

- Upon the entering into the living annuity contract, the annuitant becomes entitled to an annuity income only. The annuitant is, however, not entitled to the *underlying capital providing the annuity income* - these assets are invested and recorded in the insurer's financial records.

- The annuitant's legal interest is thus limited to the receipt of an annuity income only (as stipulated in the annuity contract) and always subject to the relevant legislation - the most important being that the living annuity may not be commuted for a single payment other than in very limited circumstances as set out in legislation. There is thus no legal mechanism whereby a person can dip into the underlying capital for a lump sum payment of any kind.

- Furthermore, a living annuity may not be transferred, assigned, reduced, hypothecated or attached by creditors.

The *annuity income*, however, forms part of the annuitant's total income and can therefore be taken into account to assess a spouse's future maintenance needs.

Annuity income

In terms of the annuity policy, an annuitant is obliged to determine the income that he wishes to receive from the living annuity within the parameters prescribed by the applicable statutory notice issued in terms of section 1 of the Income Tax Act (see sub-par (b) of the definition of *living annuity* as quoted above).

Currently, GN 290 published in Government Gazette 32005 determines that an annuitant must (at the inception of the policy) choose to receive an income from the annuity, which is not less than 2.5% and not more than 17.5%. The annuitant is furthermore entitled to amend the income he receives from the annuity (within the aforesaid parameters) on the income review date, i.e. on the policy anniversary date, which will then be applied to the revised fund value.

It is important to remember that the income from a living annuity is not guaranteed but depends on the performance of the underlying investment options and the draw-down rate selected by the annuitant.

The Supreme Court of Appeal ("SCA") in the matter of *ST v CT 2018 (5) SA 479 (SCA)* analysed a contract which also happened to be a Glacier living annuity contract, and observed that:

> *"The value of the annuity is determined solely by reference to the value of the assets specified in the Glacier contract…. In other words, the amount of the annuity is not guaranteed. The assets themselves belong to Sanlam, fluctuate with market conditions and are reduced as the annuity is drawn down. The annual amount which the appellant can draw as an annuity is not less than 2,5% and not more than 17,5% of the current capital value. On the appellant's death, Sanlam must pay any remaining capital to the appellant's nominee as an annuity or lump sum. If there is no such nomination, the capital must be paid as a lump sum to the appellant's estate."*
>
> (my emphasis)

In this matter the SCA accepted the respondent's version that the annuities belonged to the insurer and did not form part of his estate for the calculation of accrual. It concluded that the monthly or periodical payment of the living annuities was relevant for purposes of a *maintenance claim*.

Montanari v Montanari (1086/2018) [2020] ZASCA 48 (5 May 2020)

The *Montanari* matter deals with the question left open in *ST v CT* discussed above, namely whether a married annuitant's *right to future annuity payments is an asset* which can be valued and included in his or her accrual upon divorce.

The SCA reaffirmed that once a living annuity is purchased, the underlying capital is no longer accessible to the annuitant (i.e. the underlying capital is owned by the insurer and is accordingly reflected in the insurer's balance sheet). The proceeds or annuity income does not fall within the ambit of '*pension interest*' as defined in the Divorce Act. Accordingly, an annuitant cannot give part or all of the living annuities to an ex-spouse in terms of a divorce order or agree to split the annuity income with the ex-spouse.

Having said that, the court found that this does not disentitle the applicant *from any claim whatsoever* with regard to the respondent's annuities. The crux of the court's finding can be summarised in paragraph 38:

> *"[38] I align myself fully with this reasoning and see no reason why it cannot extend to the case at hand. The respondent has a clear right to the investment returns yielded by his capital re-investment with Sanlam, in the form of future annuity income which he draws from the agreement. Such annuity income is evidently an asset which can be valued, as was testified to by Mr Immerman. The trial court actually took that evidence into account, correctly so in my view. But then it erroneously considered the* ***annuity income relevant only for purposes of a maintenance*** *claim.* ***It should have found it to be an asset in the respondent's estate****, which is subject to accrual, and allowed Mr Immerman to provide a valuation of that income stream. This it failed to do. The court a quo perpetuated the misdirection by dismissing the appeal. Thus, there is no basis to deviate from the judgment in ST v CT. The application for special leave to appeal must be granted and the appeal allowed so that the error may be righted."*
>
> (my emphasis)

The SCA accordingly ordered a remittal of the matter to the trial court for the **leading of evidence on the value of the respondent's right to receive future payments** in respect of the living annuities.

Conclusion

The *Montanari* judgement can be summarised as follows: annuity income is not only relevant for purposes of a maintenance claim – it is also as an asset in the annuitant's estate, which is subject to accrual. Put differently: the value of an annuitant's right to receive future annuity payments is an asset in his estate for purposes of calculating the accrual. *(PS: the aforesaid principle will apply to conventional life annuities as well.)*

What remains to be seen, however, is **how** this *right* to future income payments from a living annuity will be **valued**, especially considering the fact that there are a number of factors which affect this valuation (e.g. market fluctuations, the draw-down rate selected by the annuitant as well as the right to adjust this draw-down rate annually, etc). What we know for sure is this: valuing this right is going to be extremely difficult. All eyes will be on the trial court's decision in this regard.