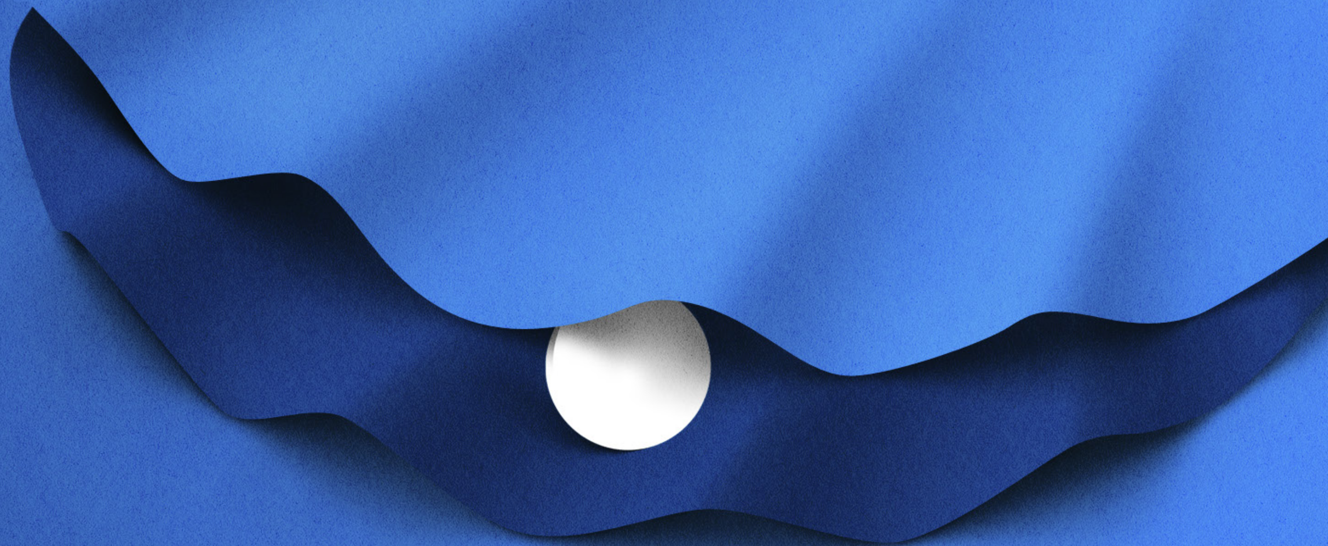
Sygnia Law Review

Two-pot retirement system proposals

July 2023



The Sygnia Law Review is a publication that primarily seeks to simplify complex legal matters affecting retirement funds in South Africa. The secondary objective is to provide the reader with a clear understanding as to how the legal matter under discussion affects the various retirement funds sponsored by the Sygnia Group (where applicable).

An update on the latest draft two-pot retirement system proposals

The two-pot system, to go ahead on 1 March 2024, is intended to marry the opposing concepts of access and preservation. On the one hand, it should ensure that members retire better, preserving their benefits until retirement (not taking their benefits in cash when they leave employment) and annuitising retirement benefits. On the other hand, Treasury recognises that members may need cash while they are still employed and members of the fund.

Treasury issued an updated version of the two-pot proposals on 9 June 2023 (the pots may also technically be referred to as "components"). Draft amendments to the Pension Funds Act have also been released by Treasury.

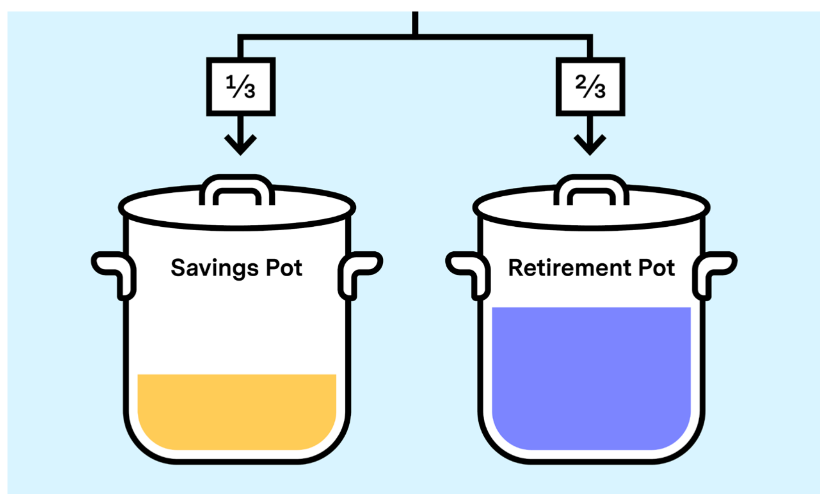
Contributions to the new pots

From 1 March 2024:

- One-third of contributions will go into **a savings pot.**
- Two-thirds of contributions will go into **a retirement pot.**
- Investment returns will be added to both pots.

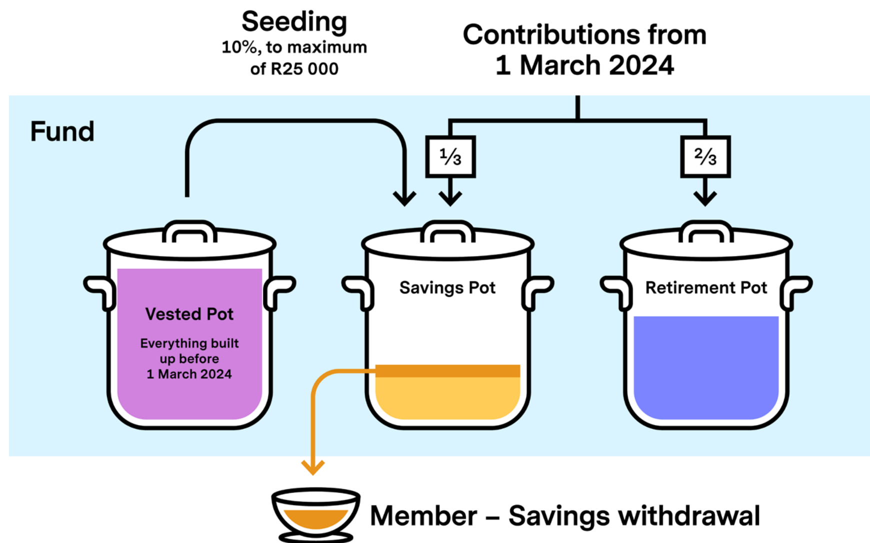
Everything saved in a fund **before 1 March 2024** (plus investment returns on this) will go into the member's **vested pot.**

Contributions from 1 March 2024



Seeding – immediate withdrawals on and after 1 March 2024

An amount of 10% of the vested pot (to a maximum of R25 000) will be allocated to the savings pot from 1 March 2024. This "seeding" can be paid out of the fund at the member's request from 1 March 2024, creating immediate access to an amount from the retirement fund (savings pot). Of course, should a member withdraw from the savings pot, they will have less money on which to retire.



A member may also decide to move funds from their savings pot and vested pot into the retirement pot – but not the other way around

Benefit payments from the different pots

While still employed

- Members can make one withdrawal from their savings pot every tax year of assessment (minimum R2 000).
- This is taxed at marginal rates (18% - 45%) as part of the member's income.
- The applicable tax method either by the retirement fund at date of withdrawal or SARS upon tax return submissions at year-end is still to be clarified.

On withdrawing from the fund/leaving employment

- Everything in the vested pot (saved before 1 March 2024, plus investment returns on that amount) can be paid as cash and will be taxed as a lump sum withdrawal.
- Everything in the savings pot can be paid in cash. If the member has already made their annual savings withdrawal, they can only withdraw in cash if the amount in the pot is less than R2 000. It will be taxed at a marginal rate.
- Nothing from the retirement pot can be paid in cash.
- Members could feasibly end up with three different tax directives.

On the member's death

- Everything will be paid out from all pots.
- The wording of the proposal is currently unclear as to what form any payments and taxation will apply.

Retirement benefit

- Everything in the savings pot can be paid out as cash according to the retirement fund lump sum tax table (0% - 36%), but the member can also choose to transfer their savings pot to their retirement pot if they prefer.
- Everything in the retirement pot is paid as an annuity.
- The vested pot is paid as part annuity and part cash.
- It will still be possible to take retirement benefits as cash if they are below a statutory minimum.
- Amounts that do not currently have to be annuitised should still be recognised.
- Taxed as normal: the lump sum on retirement and then the annuities.

A specific category of member

Different rules will apply to provident fund members who were 55 or older on 1 March 2021 and are still a member of the same provident fund: these members will contribute to the vested pot, and the same rules apply to them as applied before 1 March 2024.

Treasury will allow these members to choose to participate in the two-pot system, but they will likely lose the compulsory annuitisation vesting on their ongoing contributions after 1 March 2024 (so they would have to annuitise more of their retirement benefit).

Emigration – a change for pension and provident funds

If a member emigrates from South Africa and ceases to be a tax resident, they will be able to withdraw their retirement pot and vested pot as a lump sum, subject to the three-year rule that currently applies to members of retirement annuity funds, pension preservation funds and provident preservation funds. It is unclear whether they will be able to access their savings pot in the same way as other members over the three-year period.

Defined benefit funds are in the two-pot system on the basis of pensionable service

Contributions to the savings pot for defined benefit funds will be calculated based on one-third of the member's pensionable service increase. Contributions to the retirement pot will be based on two-thirds of the member's pensionable service increase from 1 March 2024.

Defined benefit fund members will also have a seeding allocation from their vested pot to their savings pot as at 1 March 2024, which will be done through a past-service adjustment.

The proposals for defined benefit funds do not currently offer much clarity.

Legacy retirement annuity funds can be exempted

The proposed exemption for "legacy retirement annuity fund" policies from the provisions of the two-pot system is going ahead, as Treasury recognises that these funds would otherwise have to be redesigned.

To qualify for the exemption, the legacy retirement annuity fund policy must have been entered into before 1 January 2022, and the legacy retirement annuity fund will have to submit a declaration to the Financial Sector Conduct Authority (FSCA). Exempt funds must be comprised of:

- pre-universal life policies or conventional policy with or without profits;
- universal life policies with life or lump sum disability cover; and
- reversionary bonus or universal life policies as envisaged in the insurance legislation.

The FSCA has the authority to verify that the legacy retirement annuity funds meet the exemption criteria.

Deductions

Deductions under section 37D of the Pension Funds Act (for example, for housing loans, divorce orders and maintenance orders) will need to be amended. Under the draft legislation, deductions can only be made from the retirement pot and the vested pot, but not from the savings pot. The process of refining this has started.

Necessary amendments to the Pension Funds Act to align it with the two-pot system have been drafted, and a number of other amendments are included in the draft legislation. For example, to allow for the consideration of a compensation order granted in criminal proceedings (in terms of section 300 of the Criminal Procedure Act, 1977) when benefits are withheld as a result of misconduct at the employer. The amendment also specifies that future maintenance orders may not be deducted and paid over as a lump sum (as is sometime sought to be ordered) but must be deducted as monthly amounts (or paid annually in advance if the fund is unable to deduct monthly amounts).

Still a way to go

The two-pot retirement system proposals described above are just that – proposals. Thus, they may change before the legislation is finalised. The draft legislation will go through a comment period, public hearings and a vote in Parliament. There will be a great deal to communicate to members, some of which (such as the taxation aspects) is complex. While we must all wait for the final legislation, the industry is working on what it can do now in order to be ready when the time comes.

Get in touch

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