GROUP COMPLIANCE

THE NEW TWO-POT SYSTEM: WHAT DOES IT REALLY MEAN FOR US?

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April 2023

CONTENT

The purpose of this article is to:

- Discuss our current understanding of the retirement system in South Africa
- Review changes made to the retirement system in South Africa to date
- Explain how the two-pot system will work
- Explore what this will mean for members

INTRODUCTION

When it comes to understanding the South African retirement system, the first thing members of retirements schemes would acknowledge is the complexity of it all, especially the numerous rules and penalties that apply to early withdrawals. The rules and penalties were implemented with good intentions and were aimed at nudging members to retire with an adequate amount of savings. However, statistics have consistently shown that, regardless of the high tax penalties, South African preservation rates are very low. This is primarily due to members prematurely cashing out retirement savings.[1]

REVIEW CHANGES MADE TO THE RETIREMENT SYSTEM TO DATE

Members' apparent lack of foresight regarding long-term financial planning has been a challenge for the retirement industry for years. Although fundamental changes were made to the retirement regime in the last decade, with the first proposal paper being issued in 2012, introducing the intention set by policy makers for the years ahead, all in the effort of finding a solution to this ever-present challenge.

Some of the notable changes made to the regime in recent years included the following:

- Implementing the tax-free savings account (effective from 1 March 2015)

[1] Technical Discussion Paper C for Public Comment. Preservation portability and governance for retirement funds, 21 September 2012 NT.

- Establishing a uniform tax model across all types of funds that also simplified the system (effective from 1 March 2016)
- Increasing preservation at retirement through compulsory annuitisation of provident funds (effective from 1 March 2021)
- Developing and implementing reforms to lower charges, reduce defaults, and improve market conduct and governance.

These changes were all aimed at improving retirement savings outcomes and creating a mindset focused on long-term savings.[2]

However, regardless of the changes implemented, data shared by retirement funds administrators and the South African Revenue Service (SARS), indicates that many premature withdrawals are still taking place. The data was cited in a media statement issued by the National Treasury[3] in July 2022.

The reforms previously implemented have, however, not failed to improve the regime. The two-pot system is merely the remaining proposal previously issued[4] to assist in further improving the regime.

The two-pot system aims to do this by not only seeking to increase preservation of savings, but also by considering the reality of why members so easily opt for early withdrawals. The two-pot system will allow members to contribute to a one-third savings pot, which will be accessible to them without having to change employment. The two-thirds retirement pot will be preserved until the member retires. Therefore, the member not only creates funds available for unexpected needs such as a household emergency but could also still safely keep some savings in the retirement fund.

HOW WILL THE TWO-POT SYSTEM WORK?

To simply illustrate this, all retirement funds will fall into these three categories:
- The total accumulated retirement fund (all current funds, before implementation of the two-pot system)
- 1/3 savings pot (this is funds that would be accessible annually)
- 2/3 retirement pot (this is funds that would be preserved until retirement)

National Treasury reaffirmed in the 2023 Budget Review that the new system is scheduled to come into effect on 1 March 2024. This new regime will not apply retrospectively. Therefore, the ‘fund for all total accumulated funds prior to implementation’ will be separate from the two pots (savings and preservation funds). This means that the previous rules will still apply to this fund, and new systems rules will apply to the two-pot funds.

The National Treasury has previously indicated that they are considering providing seed capital, which means that they might allow some of the monies contributed before the implementation date to be part of the savings pot. However, no further feedback on this was provided during the 2023 budget release, adding to the uncertainty of implementation.

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[2] Media statement. Retirement Reform 31 July 2022: Draft legislation for the two-pot system 3.
[3] Media statement. Retirement Reform 31 July 2022: Draft legislation for the two-pot system 3.
[4] Technical Discussion Paper C for Public Comment. Preservation portability and governance for retirement funds, 21 September 2012 NT.

WHAT DOES IT MEAN FOR MEMBERS?

Even though the National Treasury confirmed that the two-pot system will be implemented effective 1 March 2024, the industry has expressed concerns that it will take some time for the two-pot system (savings and retirement pots) to accumulate funds. In addition, more detail needs to be provided on the initial proposal on seed capital, and what this would mean to the accessible savings pot.

It would be interesting to see how this new regime plays out, especially since it appears to add further complexity to the retirement system. This is despite the efforts to not only recognise the issues resulting in early withdrawal, but also to provide funds for immediate use, allowing members immediate access to funds without having to change their employment status.