national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

MEDIA STATEMENT

RETIREMENT REFORM: DRAFT LEGISLATION FOR THE TWO-POT SYSTEM

The National Treasury released the set of four draft Tax Bills for public comment on 29 July 2022, which give effect to the 2022 Budget tax proposals. These include the 2022 Draft Rates and Monetary Amounts and Amendment of Revenue Laws Bill (2022 Draft Rates Bill), the 2022 Draft Revenue Laws Amendment Bill, the 2022 Draft Taxation Laws Amendment Bill (2022 Draft TLAB) and the 2022 Draft Tax Administration Laws Amendment Bill (2022 Draft TALAB).

The 2022 Draft Revenue Laws Amendment Bill contains key amendments on retirement reform to move towards a "two-pot" retirement system. The amendments enable South Africans to also save for non-retirement purposes (e.g. emergencies) via their retirement funds, whilst preserving more of their savings for retirement. These amendments aim to encourage members to preserve their retirement savings by making it more flexible to accommodate unforeseen pressures that members face during the span of their working life. It makes it possible for workers not to resign from their employment merely to access their retirement funds and would have assisted members during a crisis like the COVID-19 pandemic, when many employees faced reduced salaries or were not paid at all during that time.

The legislative proposals follow an intensive process of consultations, where various risks, challenges and possible perverse outcomes were identified. These amendments are the culmination of several years of consultations and engagements that took place between National Treasury, Labour, and Business stakeholders, and reflects input received from the public after the release of the discussion paper *Encouraging households to save more for retirement* in December 2021. The amendments are technically complex, as they attempt to fit a pre-retirement withdrawal scheme into existing retirement savings vehicles primarily meant to cater for long term savings.

Process to enact Bills following public comments

The process for enacting any amendments following publication involves taking public comments. After receipt of written comments, National Treasury normally engages with stakeholders through public workshops to discuss the written comments on the draft bill. The Standing Committee on Finance (SCoF) and the Select Committee on Finance (SeCoF) in Parliament are expected to make a similar call for public comment and convene public hearings on the 2022 draft bills before their formal introduction in

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Parliament. Thereafter, a response document on the comments received will be presented at the Parliamentary committee hearings, after which the bills will then be revised, taking into account public comments and recommendations made during committee hearings, before they are introduced formally in Parliament for its consideration.

Due date for public comments on the 2022 Draft Revenue Laws Amendment Bill

National Treasury hereby invites comments in writing on the 2022 Draft Revenue Laws Amendment Bill and all other draft tax bills. Please forward written comments to the National Treasury's tax policy depository at 2022AnnexCProp@treasury.gov.za and SARS at acollins@sars.gov.za by close of business on **29 August 2022.** Comments and queries on the proposed two pot system should also be sent to retirement.reform@treasury.gov.za.

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POLICY DISCUSSION AND FAQ

RETIREMENT REFORM: DRAFT LEGISLATION FOR THE TWO-POT SYSTEM

Background

South Africa has different retirement fund vehicles available to individuals, including pension funds, provident funds, retirement annuity funds, pension preservation funds and provident preservation funds. Historically, each of these funds had a different tax treatment for contributions, alongside different rules for withdrawals.

Since 2012, the South African retirement fund regime has been undergoing fundamental reforms, as initiated in a series of discussion papers since 2012, starting with *Strengthening retirement savings: An overview of proposals announced in the 2012 Budget,* which summarised the intended policy direction for future retirement reforms. To date we have been able to:

- Create tax free savings account opportunities for individuals from 1 March 2015;
- Harmonise the tax treatment of contributions to the different types of funds from 1 March 2016;
- Increase preservation at retirement through annuitisation effective from 1 March 2021; and
- Implement reforms to lower charges and improve defaults, governance, and market conduct.

The discussion paper entitled *Preservation, portability and governance for retirement funds,* published on 21 September 2012, and the paper entitled *Retirement reform proposals for further consultation*, published on 27 February 2013, both included options to increase the level of pre-retirement preservation. Data from retirement fund administrators and SARS suggests that many of these withdrawals are taking place, notwithstanding the potentially high tax rates that are applied.

Rationale for the two-pot system

The amendments in the draft bill seek to implement the remaining pre-retirement preservation proposal, as part of the longer-term retirement reform project. There are two primary concerns with the current design of the retirement system. The first is the lack of preservation before retirement, which has been highlighted in previous discussion papers. Individuals can access

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their pension funds and provident funds, in full, when changing or leaving a job. In some cases, it can create an incentive to leave employment to gain access to those funds in the short-term, putting their long-term retirement savings, and eventual ability to maintain their standard of living at retirement at risk.

The second issue is that some households in financial distress have assets within their retirement fund(s) that are not accessible, even in case of emergencies. This issue has become more prominent since the COVID-19 pandemic, with numerous calls for financially distressed individuals to be given some level of access to their retirement funds to alleviate financial hardship.

On 15 December 2021, Government published a discussion document entitled *Encouraging South Africans to save more for retirement*, which proposed a new retirement fund regime that aims to address both concerns – this would be in the form of a “two-pot” system for retirement savings. Individuals can contribute to a one-third “savings pot” which is accessible without changing their employment status, and a two-third “retirement pot” which must be preserved until retirement. The aim is to have a system that will allow resources to be available when needed, but that will also increase the overall level of savings that are dedicated to retirement.

Government has consulted widely with labour unions, fund administrators, industry, and other experts, before finalising the draft legislative proposals. It is recognised that in allowing for a withdrawal option, many funds may face liquidity risks on implementation. It is also recognised that any new system will take time to implement, as they require changes to systems and fund rules, and will also mean that funds will face new and higher costs. Many workers have low levels of savings, as they have accessed all their previous savings when they changed jobs or resigned from their jobs. For example, according to ASISA, about 61% of fund members had an average of R37 000 or less in total retirement savings (July 2020). The proposal does not include allowing immediate access to retirement funds, but rather moves to a system that can more adequately cater for emergencies in the future but should also increase preservation to improve retirement outcomes.

The key risks that counteract allowing immediate withdrawals include:

a) Risk of members drawing down a substantial part of their retirement saving, leaving them more vulnerable when they retire;

b) Risk of lower investment returns for members as more funds are withdrawn and less of their savings are invested;

c) Risk to financial viability of specific funds and fund types that were not designed to accommodate such a withdrawal; and

d) Risk of liquidity runs on some funds alongside a negative shock on asset prices on the implementation date or soon after.

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Summary of policy proposals

Contributions: All pension funds, pension preservation funds, provident funds, provident preservation funds or retirement annuity funds will be required to allocate contributions from 1 March 2023 to a new “retirement pot” and a “savings pot”. Up to 1/3 of contributions can flow to the “savings pot”, while the remainder should flow to the “retirement pot”. Contributions will remain deductible up to the specified caps, but any contributions more than 27.5% of taxable income or R350 000 p.a. can only flow into the “retirement pot”. Only members who were 55 years of age or older on 1 March 2021 will still be able to contribute to their provident funds – but only until they leave the fund or retire.

> ***Question:*** *Do members have to re-enrol to funds for the new “two pot” system?*
>
> ***Answer:*** *No. Existing funds will be adapted to accommodate both components into the fund. Each fund will have to review their fund rules to do so. After the date of implementation, members’ contributions will be split into the two pots by the fund.*

Existing funds: All contributions and growth that are accumulated before 1 March 2023 (i.e., retirement interest) will have to be valued at the date immediately prior to implementation, to enable vesting of rights (called the “vested pot” a term used to refer to all the different funds a person may hold on that date). The rights of members in these funds will be protected – but it also means that the conditions that were attached to those contributions will remain in place.

The “savings pot” will then be accumulated from 1 March 2023, which means that the proposal for seed finance or capital into either pot is not supported. While there were many public requests for immediate access to accumulated retirement funds, it would not be in the best interest of members or the stability of retirement funds to do so, particularly at a point when the value of accumulated assets is already under pressure. These products were not designed to accommodate such a withdrawal, and it is members who will suffer if their retirement interest is diminished by large lump sum withdrawals.

> ***Question****: Should I withdraw my funds from my pension or provident fund to exercise my right to a pre-retirement withdrawal? What if I lose my job and I always planned to have access to a pay-out from my pension if that were to happen?*
>
> ***Answer****: All your rights will be protected for the funds that you have already contributed. The new pots will grow from the date of implementation, while the “vested pot” will still operate under the rules that were in place before the amendments.*
>
> ***Example****: Person A is employed and has R200 000 in a provident fund at the time of implementation of these amendments on 1 March 2023. From 1 March 2023 onwards, one-third of their contributions are deposited into an “savings pot” and two-thirds of their contributions are deposited into the “retirement pot”.*

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After two years, there is R20 000 in the "savings pot", R40 000 in the "retirement pot' and R220 000 in the "vested pot". Person A faces some financial difficulties and can withdraw the R20 000 from their "savings pot" without resigning to gain access to their retirement savings. Any amounts withdrawn from the "savings pot" would be included in Person A's taxable income. No further withdrawals from the "savings pot" can be made for another year.

After another two years, Person A has R25 000 in the "savings pot", R100 000 in the two-thirds "retirement pot" and R250 000 in the "vested pot". Person A resigns to join another company. On resignation, the one-third "savings pot" and the two-thirds "retirement pot" can either stay in the current fund or be transferred to another fund which has a "savings pot" and a "retirement pot", potentially at their new employer. The one-third "savings pot" would still be accessible at any time. For the "vested pot", Person A would have the following options:

- *Withdraw the R250 000 vested right, although the amount would be subject to tax according to the withdrawal tax table;*
- *Transfer the R250 000 to another "vested pot" within a provident preservation fund. The amount would remain eligible for a once-off withdrawal of up to the full value at any point before retirement. The transfer would not have any tax consequences, but any future withdrawal(s) would be treated as indicated directly above; or*
- *Transfer the R250 000 to the "retirement pot" to consolidate retirement interest, which would forfeit the once-off withdrawal. The transfer will not have any tax consequences.*

After another 10 years, Person A has reached retirement age. There is R75 000 in the "savings pot" and R600 000 in the "retirement pot". Person A retires and can either withdraw the R75 000 from the "savings pot" as cash (taxed through the retirement lump sum tables) or transfer any remainder to the "retirement pot". Upon retirement Person A is required to purchase an annuity with the balance in the "retirement pot", which would amount to R600 000 upon retirement, in the absence of any transfers from the "savings pot" or "vested pot".

Pre-retirement withdrawals: Members will still be able to withdraw from the "vested pot", which will be taxed through the applicable pre-retirement lump sum table. Should they need to, members will also be able to withdraw from the "savings pot" once in 12 months, with a minimum withdrawal of R2 000. All withdrawals from the "savings pot" will be included in taxable income, which means that it will attract the appropriate marginal tax rate to ensure all sources of income are taken into account to determine taxable income.

***Question**: When will I be able to make my first withdrawal from the "savings pot"?*

Answer*: The pot will grow from 1 March 2023. You will be able to make a withdrawal once there is at least R2 000, but only once a year. But if you withdraw you will pay tax at your marginal rate, while you will be able to withdraw from the "savings pot" with lower tax if you leave the money in the pot. You will be rewarded with a lower tax payment if you do not withdraw from your savings and preserve the savings until you retire – it is, therefore, in your interest to only withdraw from your savings if you really need to and have no other alternative.*

Example: *If Person B makes a withdrawal on 21 March 2025, the next withdrawal can only be made on or after 22 March 2026. The minimum withdrawal amount is proposed to be R2 000. These withdrawals will be subject to fund rules allowing them. Withdrawals from the "savings pot" will be added to taxable income in the year of withdrawal. Should an individual opt not to make a withdrawal within a specific twelve-month period, the funds available in the "savings pot" will still be available for withdrawal in the subsequent twelve-month period.*

Question: *Will pre-retirement withdrawals really make much difference?*

Answer: *Early withdrawals will have two important implications. Firstly, you lose out on the returns to investment in your savings pot. Secondly, you pay more tax if the withdrawal is before retirement. The size of the impact is strongly related to the size of withdrawals – as will be clear from comparing the two examples below.*

Example*: Person C is 54 years old on 1 March 2023. They have taxable income of R300 000 p.a. and can contribute R30 000 to their retirement fund at the start of every year – of which R10 000 flows to the "savings pot". What would the impact be of withdrawals from the savings pot?*

We assume a return of 10% p.a. and current tax tables to apply throughout the analysis. We further assume that Person C retires at the age of 64 on 1 March 2033, at which time they withdraw the remainder of the savings pot as a lump sum – which we assume to be their only income for that year.

Scenario 1: *Person C makes three relatively small withdrawals of R7 000 at the start of 2024, 2028 and 2032, as a supplement to their income due to unforeseen circumstances. This means that their tax liability in those years increase by R1 820. At retirement, the three withdrawals will result in a lump sum that is R36 249 lower than it would have been without the early withdrawals. Person C can withdraw R139 062 upon retirement in 2033. After applying the tax-free R500 000 lump sum upon retirement, Person C will pay R5 460 more in taxes over the period 2023 – 2033 and their disposable income that is R20 709 lower than it would have been without those withdrawals.*

Scenario 2: *Person C makes one big withdrawal of R100 000 at the start of 2031 due to unforeseen circumstances. This means that their tax liability that year will be*

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R28 345 higher in that year. As they withdraw almost the whole pot in 2031, they only have R54 312 left to withdraw upon retirement. Beyond the withdrawal of R100 000, investment growth of R21 100 is foregone. After applying the tax free R500 000 lump sum upon retirement, Person C will pay R28 345 more in taxes over the period 2023 - 2033 than they would have without the withdrawal. Their net income over the whole period is R49 345 lower than it would have been if they waited 2 years longer before making the big withdrawal from their "savings pot".

Retirement: Amounts contributed to the "retirement pot" cannot be accessed before retirement. At retirement date, the total value must be paid in the form of an annuity (including a living annuity). The current minimum amount for purchasing an annuity (*de minimus* of R167 500) will apply to the retirement pot.

Any funds available in the "savings pot" at retirement or death can either be withdrawn in full or transferred to the "retirement pot". Where the member opts to withdraw funds from the "savings pot" as a lump sum on retirement, the available balance will be taxable as a retirement lump sum subject to the retirement lump sum table.

Change of tax residence: Full withdrawals from the retirement, savings and vested pots can take place if an individual ceases to be tax resident for a period of at least 3 years – with the appropriate tax treatment based on the facts and circumstances of the case.

Transfers: Transfers will remain tax neutral. Individuals cannot transfer amounts out of the "retirement pot" but transfers can be made into the "retirement pot" from other pots, or from one "retirement pot" to another "retirement pot". No transfers can be made into the "savings pot", unless they are from another "savings pot" and subject to fund rules. "Retirement pots" and "savings pots" cannot be split between funds (i.e., you cannot transfer a "savings pot" to another fund without also transferring the relevant "retirement pot" to that same fund).

Further work and coming reforms

The Minister of Finance also confirmed the intention of further retirement reforms related to auto-enrolment (or mandatory) and greater consolidation of retirement funds. Consultations for these reforms will continue over the next year, and legislative proposals finalised in 2023 for tabling in Parliament.

The National Treasury is also exploring complementary measures to better incentivise long-term savings alongside better financial planning and advice to promote higher levels of saving and preservation, including progressively increasing the percentage saved (e.g., from 12% to 15% of income).

Summary/conclusion

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Government is of the view that the two-pot system option will present a better balance between ensuring preservation of retirement savings and allowing some withdrawals through a savings vehicle incorporated into the retirement funds.

For other options considered to assist fund members in the state of emergency, please consult the December 2021 paper *Encouraging South African households to save more for retirement.*

The proposal is for retirement funds to direct one-third of their retirement contributions to a savings pot and two-thirds preserved in a retirement pot. Pre-implementation date vested rights will be preserved. Offering of the savings pot will be subject to fund rules i.e., will not be compulsory, meaning that a member may opt out of the savings pot. A minimum of R2 000 may be withdrawn in a 12-month cycle, with no conditions attached to withdrawals from the savings pot, subject to fund charges and tax. No pre-retirement withdrawals will be permissible from the retirement pot. Transfers of the savings and retirement pots between funds is allowed.

The proposed 2023 implementation date is optimistic, because fund rules need to be changed, there will be systems changes within retirement funds to enable the two-pot system and SARS also needs to create capacity to cater for the new pots and track withdrawals. Furthermore, retirement funds must train employees, educate fund members about the reform and its implication.

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