ANNEXURE B: Impact of annuitisation on provident fund members

In terms of the Taxation Laws Amendment Bill, 2013, members of provident funds will be required to purchase an annuity with two-thirds of their accumulated balance of contributions made after 1 March 2016, provided this balance is greater than R247 500 on the day they retire and they were under the age of 55 on 1 March 2016.

The length of time it will take for an individual worker's balance to exceed this threshold therefore depends on:

- The sum of employer and employee contribution rates to their provident fund (workers with higher contribution rates will be affected sooner)
- Their current salary, and growth in their salary between now and when they retire (workers with higher salaries will be affected sooner)
- Investment returns between now and when they retire (higher investment returns will mean workers are affected sooner)
- How the threshold of R247 500 is increased due to inflation between now and when they retire (as the threshold is increased over time, the effect on workers will be delayed)

We used SARS data on the distribution of earnings of provident fund members to estimate the length of time it will take workers to be affected by the annuitisation requirements. The SARS data is provided by earnings bands. We made the following <u>conservative</u> assumptions (which all have the effect of <u>overstating</u> the likely impact of annuitisation). These results can therefore be thought of as a <u>worst case</u> scenario:

- The provident fund member continues to remain in employment until retirement (and does not resign at any point and withdraw their contributions before retirement)
- Total employer and employee contribution rates are 15% (for all but the highest-paid workers, they are likely to be less than this. The average bargaining council fund, for instance, has contribution rates closer to 12%)
- Salary growth is a constant 8% p.a. (increases are likely lower than this for older workers, who will be affected first)
- Investment returns after costs are a constant 10% p.a. (about average for retirement funds)
- The annuitisation threshold remains at R247 500 (it is likely to increase over time)
- All workers in each earnings band are younger than 55 (many are likely to be older than 55, and so unaffected)

Using SARS data on the distribution of earnings of the 2.5m provident fund members who have made their own employee contributions in 2012-2013[1], the following results can be calculated:

Number of years before required to annuitise	Pensionable salary as at 1 March 2016, above which members would be required to annuitise	Proportion of provident fund members annuitizing
1 (2017)	R 1 700 000	< 1 %
2 (2018)	R 760 000	1.0%
3 (2019)	R 470 000	3.6%
4 (2020)	R 320 000	7.2%
5 (2021)	R 235 000	12.4%
6 (2022)	R 180 000	17.7%
7 (2023)	R 145 000	28.4%
8 (2024)	R 115 000	37.6%
9 (2025)	R 95 000	43.8%
10 (2026)	R 77 500	49.1%

The table illustrates the proportion of provident fund members who would be required to purchase an annuity in future years and the expected income as at 1 March 2016 of those members who would be impacted in each year. For example, in 7 years' time (or by 2023) we would expect that provident fund members who had a pensionable salary that is greater than R145 000 on 1 March 2016 would be required to purchase an annuity (given the assumptions). This corresponds to around 28 per cent of the current provident fund members who are below the age of 55[2].

We note that even in this <u>worst-case scenario</u>:

- Higher-earning workers are affected first, with those earning more than R1.7m p.a. affected within one year. However, theoretically this could only occur for someone who is 54 on 1 March 2016 and retires the following year as those over the age of 55 are unaffected.
- Only workers earning more than R235k p.a. on 1 March 2016 (around 12 per cent of provident fund members) will be affected in the first 5 years after 1 March 2016
- Nearly half of all provident fund members – those earning less than R70k p.a. on 1 March 2016 – will not be affected for at least 11 years.

If the R247 500 threshold is increased by 5% p.a. – so broadly in line with inflation – then the annuitisation requirement will take effect more slowly, and it will be 14 years before workers who have a pensionable salary of R77 500 will be affected.

[1] There is no data available for provident fund members who only have an employer contribution and do not contribute themselves.

[2] This may be an overestimate as we are assuming that the overall distribution is the same as the distribution for those under the age of 55 who would be impacted by these proposals.