national treasury

Department:
National Treasury
REPUBLIC OF SOUTH AFRICA

Frequently Asked Questions on Retirement Reform

Background on retirement reforms

1. What is retirement reform?

Retirement reform is a process whereby government, through policies, seeks to:

- Encourage employees to save and provide adequately for retirement to ensure that they retire comfortably and have income that lasts for their lives in retirement.
- Encourage employers to provide retirement saving plans to their employees as part of the employment contract.
- Ensure that employees receive good value for money for their retirement savings and are treated fairly, and that their savings are prudently and diligently managed, and are kept informed of their retirement savings.
- Improve standards of retirement fund governance, including trustee knowledge and conduct, and the protection of members' interest.

2. How far is the retirement reform process?

Retirement reform is an ongoing process and will take some time to complete. The aim is to ensure that whatever reforms are undertaken do not result in unintended consequences. In this regard, it is also imperative to learn from other countries which are going through similar policy debates and reforms. Some critical aspects of the reform took effect in 2013 (e.g. enhancing governance through the Financial Services Laws General Amendment Act, No 45 of 2013), March 2014 (the increase in the tax free lump sum on retirement, as announced in the Minister's Budget Speech) and in March 2015, the equalisation of the tax treatment of contributions into retirement funds (i.e. pension, retirement annuities and provident funds) will become effective.

3. **How will the retirement reform benefit workers?**

It is envisaged that workers will be encouraged to save (more) through retirement funds, and be able to provide for their own retirement and curb old-age poverty and excessive dependency on relatives and the Government. Members of provident funds will, similar to members of pension and retirement annuity funds, now be able to claim a tax deduction on their contributions to their funds, which has the potential to increase take home salaries. The 2013 enacted governance provisions will ensure that trustees of retirement funds manage the funds diligently and properly, and that employers will now be personally liable for failure to transfer collected retirement contributions into a pension fund.

4. **What are the economic implications of retirement reform?**

The National Development Plan acknowledges the importance of higher savings and investments in promoting economic growth in the country. These savings can come from domestic and/or foreign sources. Foreign savings are an important source for domestic investment but are short-term in nature and can be volatile, thereby affecting the Rand. Our domestic savings have generally been very low, and therefore need to be harnessed to better promote economic growth. At an individual level, retirees will increase their chances of a financially better life in retirement.

5. **Where can I find information about the retirement reform?**

Information can be obtained from the National Treasury website by following this link: http://www.treasury.gov.za/publications/RetirementReform/

6. **Will I have access to my pension or provident fund if I resign or lose my job before P-day?**

Yes. This will only change when the preservation requirement becomes law. Vested rights (i.e. accumulated retirement savings before new laws take effect) will be protected and limited withdrawals will only be allowed on new contributions made after preservation becomes law.

Annuitising retirement savings (alignment of provident and pension funds)

7. Which reforms are related to provident funds?

Government is aligning the benefits of provident funds to those of pension and retirement annuity funds at retirement. This means that provident fund members will be required to convert at least two thirds of their retirement savings into an annuity or pension when they reach retirement, instead of a once-off large sum of cash. Further, members of provident funds will also enjoy the same tax deduction on their own contributions as currently applied to contributions by pension fund members, enabling them to potentially take home a slightly higher monthly salary. Vested rights are protected with the provident fund change (see below).

8. When will the provident fund reforms come into effect?

The reforms on provident funds are now law contained in the Taxation Laws Amendment Act No. 31 of 2013 and will come into effect on 1 March 2015. The policy and law was thoroughly consulted on with the public, which includes the unions and employer.

9. What is T-Day and has it come to effect?

T-day is the day when a new tax regime for retirement funds is to be introduced; it is now officially 1 March 2015. From this date most taxpayers will be able to deduct a higher amount in contributions from their income. T-day is also the day when the alignment of provident and pension funds comes into effect.

10. How will I be affected by the new legislation on provident funds?

The effect of the alignment between provident and pension funds will take a long time to have an impact on members, and will not affect provident fund members who are currently close to retirement. All provident fund members will still be able to take all their retirement savings that would have been accumulated as at 1 March 2015 as a cash lump sum whenever they go into retirement. The conversion of a portion of the retirement money into income at retirement will only apply to <u>new</u> contributions made by those who are <u>younger than 55</u> when the new rules come into effect. This means that members who are 55 years and older on 1 March 2015, when the new rules come into effect, will not be affected. They will therefore still be able to even take (new) contributions made after the new rules as a cash lump sum in retirement. Further, workers who are below 55 years on 1 March 2015, will not be asked to annuitise or take a pension on the portion of new contributions if the total of those new contributions is less than the R150 000 ("*de minimis* rule") threshold when they reach retirement. Irrespective of age, whatever a member has accumulated in the provident fund as at 1 March 2015, will be available to them as a cash lump sum when the person retires (i.e. protection of vested rights).

Box 1: Examples of How the Annuitisation Requirement for Provident Fund Benefits will apply

Scenario 1: All provident fund members who are 55 years old and above on 1 March 2015 will <u>not</u> be affected by the change.

Provident fund member A is <u>55 years old on the date of implementation of legislative changes (1 March 2015)</u> and has accumulated R350 000 as at 1 March 2015. At retirement on 1 March 2020, member A is 60 years old and has accumulated an additional R70 020 (i.e. "new contributions" after 1 March 2015). Member A, will therefore, upon retirement, be entitled to take the entire provident fund benefit (i.e. R420 020) as a cash lump sum.

Scenario 2: A provident fund member who is less than 55 years old on 1 March 2015, with new contributions <u>below</u> the *de minimis* threshold amount of R150 000

Provident fund member B is <u>50 years old on the date of implementation of legislative changes (1 March 2015)</u> and has accumulated R280 080 as at 1 March 2015. At retirement on 1 March 2025, member B is 60 years old and has accumulated an additional R140 040. Member B, will therefore, upon retirement, be entitled to take R420 120 as a cash lump sum at retirement (made up of the first R280 080 plus R140 040 which is the benefit accumulated after 1 March 2015). Member B is not affected by the annuitisation requirement because the amount accumulated after 1 March 2015 (i.e. "new contributions") is less than the R150 000 *de minimis* threshold amount.

Scenario 3: A provident fund member who is less than 55 years old on 1 March 2015, with new contributions <u>above</u> the *de minimis* threshold amount of R150 000

Provident fund member C is <u>45 years old on the date of implementation of legislative changes (1 March 2015)</u> and has accumulated R237 000 as at 1 March 2015. At retirement, on 1 March 2030, member C is 60 years old and has accumulated an additional R210 060. Member C, will therefore, upon retirement, be entitled to take R307 020 as a cash lump sum at retirement (made up of the first R237 000 plus R70 020 which is one-third of (R210 060) the benefit accumulated after 1 March 2015, i.e. "new contributions"), and the remaining (two-thirds) R140 040 must be used to purchase an annuity/pension.

11. What happens if I am a member of a provident fund and want to access my money upon resigning?

We encourage members of both pension and provident funds to preserve their savings. However, provident members will be able to take all their retirement savings as a cash lump sum upon resignation (with tax implications), or to preserve it with a financial institution, or old or new employer (no tax implications).

12. Why is Government aligning provident fund benefits with those received from pension and retirement annuity funds?

To help retirees from provident funds to better manage longevity risk (i.e. the risk of outliving your retirement savings when in retirement) and investment risk (the risk of up and down movements of market prices in securities), and prevent them from spending their retirement assets too quickly and becoming excessively reliant on the State or their families for support.

13. Will I be affected by the alignment if I am contributing to a pension fund?

No. There won't be any changes for those retiring from pension funds. The pension fund status quo will remain in terms of the annuitisation requirement (i.e. getting a pension when one retires). Whenever a member changes jobs pre-retirement, accumulated balances on P-day (when preservation comes into effect) will not be affected and can be withdrawn as per current rules.

General questions

14. Do the retirement reforms affect me if I am a member of the Government Employees Pension Fund (GEPF), or other Government related retirement funds?

The GEPF is a pension fund; changes related to provident funds will therefore not affect members of the GEPF. However, given the introduction of a higher cap for tax deductions, members of the GEPF will now also be able to contribute more for retirement purposes.

15. Is Government going to take away or deny me access to my money?

No. There is <u>no</u> intention by Government to nationalise workers' pension/provident funds, or to prevent them from accessing their money. Instead, Government is proposing important measures to encourage workers to keep their savings until retirement, and to convert some of these funds into income at retirement. Workers should therefore not panic and resign to access their pension savings.

16. How do the reforms affect me if I take early retirement or get disabled or deceased

A person that takes early retirement, or gets disabled or deceased will be paid out their retirement benefit as according to the rules of the fund they are contributing into.

17. What are prescribed assets and how do they affect my pension fund?

Prescribed assets mean that the Government authorises the investment of retirement savings into certain developmental assets. There are no prescribed assets in the South African retirement industry landscape. Regulation 28 of the Pension Funds Act regulates the maximum exposure of retirement funds to various assets. Government is of the view that retirement funds are sufficiently invested in infrastructure, through government and state owned company bonds, such that there is no need to prescribe how much each fund ought to invest in other assets of a developmental nature.

Proposals on pre-retirement preservation

18. What is preservation?

Preservation is when money saved for retirement through pension, provident and preservation funds remains in those funds until the person retires, or is rolled over into another similar retirement savings vehicle without incurring taxes or penalties when a person changes jobs.

19. What is Government's proposal on preservation?

Government is proposing partial preservation only of <u>new contributions</u> that come into the retirement system after new legislation comes into effect. Limited withdrawals will be allowed and accumulated savings on date of implementation of legislation will not be affected.

Box 2: Real-life Example of the Benefits of Preservation

Period of saving	Paid-in contributions (R500 pm)	Expected amount after the saving period (contributions +growth)
0 years	R60 000	R81 632
20 years	R120 000	R227 823
30 years	R180 000	R489 628

Ayanda is 25 years old and starts saving by contributing R500 from her salary every month into a retirement fund. She earns a nominal return of 6% per year after costs (estimated at 2% per year). If Ayanda continues to contribute R500 per month until she reaches 55 years, she would have paid in R180 000 in contributions (i.e. excluding growth). Assuming that her contributions grew by 6% per annum (nominal return after costs) she would then have a lump sum at age 55 of R489 628 (i.e. 2,7 times the monthly contributions she paid in 30 years).

However, if Ayanda resigns after 10 years and withdraws her saved retirement money as a lump sum, which in 10 years' time is R81 632 and then starts saving again for her retirement in Year 11 without having preserved the R81 632, she will only have R227 823 at retirement (both contributions and growth), i.e. less than half of what she would have been able to retire with (ie R489 628) if she did not withdraw her accumulated R81 632. Ayanda would now have to more than <u>double</u> her contributions for her to be able to catch-up and have the retirement capital of R489 628.

Using the current tax rates (2014/2015) on pre-retirement lump-sums, Ayanda will also be taxed on the R81 632 pre-retirement lump-sum withdrawal, resulting in her final withdrawal amount being R71 438 ((R81 632-R25 000) × (1-18%) + R25 000). The taxation increases with higher withdrawal amounts.

20. Why is Government encouraging preservation?

People tend to change jobs a number of times in their working lives. Every time an employee changes employment, they cash in their accumulated retirement savings, thereby retiring with insufficient retirement benefits. Cashing in before retirement also prematurely erodes security in old age, undermines the alleviation of chronic poverty and increases reliance on others.

21. Will preservation affect all retirement funds?

Yes. Preservation will apply to all provident and pension funds, with vested rights being protected (i.e. accumulated savings will not be subject to restricted withdrawal rules). Retirement annuity funds already have a preservation element in that policy holders cannot withdraw from the fund until they are 55 years old.

22. What is P-day?

P-day is the effective date for the implementation of preservation proposals. This date has not yet been decided on.

23. What does 'protection of vested rights' mean?

Protection of vested rights means that all accumulated retirement savings in retirement funds on the date of implementation of the preservation legislation will be subject to the current rules and 100% access to these savings will be allowed on resignation or withdrawal. Employees therefore, need not panic and resign in order to access the money that has been accumulated up to P-day.

24. When will preservation come into effect?

Preservation will happen at some point in future. A date for effecting preservation has not yet been announced, because there is still no policy decision on the exact and final nature on the preservation rules. Preservation is still a proposal that is open for public comment and debate. Before any form of preservation comes into effect, legislation will be passed which will still be made available for public comment before being passed into law.