momentum
corporate

Legal update 4 of 2023:

The impact of the new two-pot retirement system

The second draft two-pot Tax Bill (draft Tax Bill) was issued on 9 June 2023. Under the two-pot retirement system, the retirement savings of members who belong to the FundsAtWork Umbrella Funds (the Funds) on the two-pot system implementation date, will have three components, a **vested**, a **savings** and a **retirement** component. As the final legislation on the two-pot system has not yet been issued, we cannot say for certain when it will be implemented and what its impact will be on the retirement savings of members of the Funds. But based on the draft Tax Bill, it seems that the implementation date will be 1 March 2024 and the impact will be:

There will be NO impact on a member's retirement savings accumulated before 1 March 2024, ie the vested component

1. A member's accumulated retirement savings in the Funds immediately before **1 March 2024** will be called their vested component. The vested component of a member's retirement savings will **not be subject** to the two-pot system rules but will remain subject to the rules, rights, limitations and tax tables in place before 1 March 2024.

2. Members will still be able to take their vested component in cash on resignation, dismissal, and retrenchment. On retirement, provident fund members will still be able to take their full T-day vested benefit in cash, and up to one-third of their T-day non-vested benefit in cash and if it is R247 500 or less, they may take the whole T-day non-vested benefit in cash.

3. Just to remind you:

   - For a provident fund member who was **younger than 55** on 1 March 2021 (T-day), their T-day vested benefit is their retirement savings on 28 February 2021; and their T-day non-vested benefit is their retirement savings from T-day.

   - For a provident fund member who was **55 or older** on T-day and remained in the same provident fund, their T-day vested benefit is their retirement savings on 28 February 2021 and all their retirement savings from T-day. These members will not have a T-day non-vested benefit.

   - For a provident fund member who was **55 or older** on T-day but transferred to a new fund after T-day, their T-day vested benefit is their retirement savings on date of their transfer to the new fund; and their T-day non-vested benefit is all their retirement savings in the new fund.

4. The Funds must pay all members' contributions into their new savings and retirement components from 1 March 2024. Members can't make any further contributions to their vested component after 1 March 2024. But members who belonged to the FundsAtWork Umbrella **Provident Fund** on 1 March 2021, who were 55 years or older on that date, and have remained members of the FundsAtWork Umbrella Provident Fund can choose to continue contributing to their vested component. The FundsAtWork Umbrella **Provident Fund** will not maintain a savings and retirement component for them and none of the two-pot rules will apply to them.

Members will have early access to the portion of their retirement savings paid into their savings component

1. From 1 March 2024 the Funds must allocate one-third of a member's contribution into their new savings component. The Funds must also transfer to the savings component an amount of 10% of the member's vested component on 1 March 2024, up to a maximum of R25 000, as a once-off transfer. For example, if the amount in the member's vested component is R150 000 on 29 February 2024, the amount that will be transferred is R15 000, ie 10% of R150 000.

2. A member can withdraw the money in their savings component at any time, but only once in a tax year, ie 1 March to 28 February of the next year, and they do not have to provide any reason for it, eg for financial relief. This means if a member chooses to take the full or a portion of the "opening balance" in their savings component or a portion of it during March 2024, they can only take money from their savings component again in March 2025.

3. There is no limit on the maximum amount a member can withdraw but the minimum amount is R2 000. This means that a member cannot make an annual withdrawal from their savings component if they have less than R2 000 in it. But the draft Tax Bill provides that if a member resigns from their employer and they have already made their annual withdrawal, they can make an additional annual withdrawal of the total balance in the savings component if it is less than R2 000.

4. The tax payable on any money taken from the savings component before retirement will depend on the member's taxable income and the SARS tax rate that applies to their income band, ie the member's marginal tax rate.

5. So, after 1 March 2024, a member who is in financial distress does not have to resign and run the risk of not finding a new job as they will be allowed to take a portion of their retirement savings to ease their financial difficulties. This means that the two-pot system will create an additional or new source of financial relief for members.

6. Although the draft Tax Bill does not specify it, government has said it only wants members to withdraw money from their savings component in an emergency. Government reiterated in the media statement issued with the draft Tax Bill that members must be encouraged to only withdraw money from their savings component as a last resort and to try and preserve their retirement savings for their retirement.

7. The Funds want to emphasise that although under the two-pot system members' retirement savings will be divided into three components, members' retirement savings should still be seen as one benefit with only one goal, which is long-term savings. Preserving the money in all three of the components will assist them to make their retirement more comfortable. Members also need to understand the significant impact of compound interest on their retirement savings when they leave their total retirement savings untouched to grow over the long term.

Members should be able to retire more comfortably

1. It may seem at first glance that government's intention with the two-pot retirement system is to allow members to use their retirement savings as an additional source of financial relief, but that is not the case. Government primarily wants to ensure that members preserve their retirement savings so that they have more money when they retire and avoid depending on family members and the Government.

2. People tend to change jobs several times in their working lives. Under the current legislation, every time they change jobs, they can cash in their retirement savings. This results in them not saving enough for retirement. It is this practice that government wants to stop, and they are doing it by introducing the two-pot system.

3. From 1 March 2024, Funds must allocate two-thirds of a member's contributions into their retirement component, and the members will not be allowed to take any money from it until they retire. This means members will have to preserve the bulk of their retirement savings until they retire and at retirement, they will have to use the whole amount in their retirement component to buy a pension. Members will only be able to take their retirement component in cash when they retire if the amount in the retirement component, together with two-thirds of the amount in the vested component, is equal to or less than R165 000. For example, the amount in their retirement component is R50 000 and the amount in their vested component is R120 000. R50 000 plus two-thirds of R120 000 (ie R80 000) is R130 000. This is less than R165 000, so the member can take the full R50 000 in their retirement component in cash.

4. Government will consider legislation dealing with withdrawals from the retirement component if a member is **retrenched** and has no alternative source of income, in the **second phase** of the two-pot system. For now, if a member is retrenched, they will not be entitled to take any money from their retirement component.

5. So, on retrenchment, dismissal and resignation from employment, the money in a member's retirement component cannot be accessed and they will have to wait until they retire.

6. On retirement, a member may take in cash the remaining balance in their savings component and to further encourage the preservation of retirement savings, the draft Tax Bill provides that it will be taxed at the retirement lump sum tax tables, and not at the member's marginal tax rates. If a member does not take any money from their savings component before they retire, they could potentially get an amount of up to R550 000 tax free from their savings component on retirement.

Members must be able to make informed decisions

A member can access the money in their savings component without their employer having to initiate the process. This means there will be a shift from employer-driven decisions to member-initiated decisions and it will be up to the member to decide to:

- take money from their savings component. They will have to strike a balance between their immediate financial needs and making sure they have enough money to retire comfortably.
- transfer money from their savings component and/or vested component into their retirement component and lock it in to ensure a comfortable retirement. The money transferred to the retirement component will not be accessible as a lump sum and will be paid as a pension at retirement.
- invest the money in their savings component in a different investment portfolio(s) than the Funds' approved default investment portfolio.

This shift means that member education will play a crucial role in the successful roll out of the two-pot system as members need to fully understand what amount they can access, when and how they can access it, as well as the impact these decisions will have on their retirement savings. The Funds have a communication strategy in place and together with the retirement benefit counsellors, will assist the members in this journey to make sure that they can make fully informed decisions.

Employers can assist by providing the Funds with their employees' up-to-date contact details so the Funds can communicate and inform them of their rights and responsibilities under the two-pot system.