SESHEGO
BENEFIT CONSULTING

Insights

NOVEMBER 2020: EDITION 10 2020

In case you missed it…

Retirement Reform – Final Implementation 1 March 2021

Retirement Reform has been on the table for several years and it is finally to be implemented on 1 March 2021. In this publication we discuss the implications of these major changes for retirement funds and their members.

1. **Why is Retirement Reform needed?**

1.1 Government has been concerned for a very long time that the majority of South African citizens who reach retirement as members of retirement funds are underfunded for retirement. There are many reasons for this, such as the fact that members who leave the service of the employer prior to retirement notoriously elect to receive their withdrawal benefit in cash, rather than preserving the benefit in another vehicle for retirement funding. The regulatory authorities attempted to prevent this leakage in March 2019 when Regulation 38 to the Pension Funds Act, came into effect. The Regulation provided for preservation within the retirement fund as the default if a member leaving service prior to retirement failed to make an election with regard to the manner of payment of his benefit.

1.2 However, National Treasury and Government have realised for some time that the current dispensation applicable to payment of benefits from provident funds is probably the major reason for members being underfunded at retirement. A member of a pension fund is only able to commute one third of his or her retirement benefit for a lump sum – the current threshold for the amount that may be commuted in full is R247,500 and the remainder of the benefit must be paid as an annuity.

By contrast, a member of a provident fund can elect to receive payment of the entire retirement benefit as a lump sum. South Africans do not have a good track record with regards to saving and investing.

Historically many retiring members have spent the major part of the lump sum paid from a provident fund rather than investing it prudently, with the result that their retirement capital is completely inadequate to support them throughout retirement.

Many such citizens then rely on the old-age pension offered by the state if they hit hard times going forwards into their retirement.

This essentially defeats the Government's purpose in offering tax incentives to members of retirement funds during their working lives on the assumption that they will be self-funding and will not become a burden on the state on retirement. Ultimately the aim of Government and National Treasury is to preserve retirement savings and thereby avoid members who contributed to retirement funds during their working life falling into poverty in their old age.

1.3 The authorities have, therefore, decided to change the provision that a provident fund can pay the total retirement benefit as a lump sum by phasing in the annuitisation of provident funds.

1.4 The uniform retirement system created by the annuitisation of provident funds will also make savings for retirement easier to understand for the member. The same tax regime now applies to both pension and provident funds which will have the effect of ironing out previous complexities and anomalies.

2. What does the annuitisation of provident funds mean for retirement

2.1 Going forward, members who retire from provident funds will have to use two-thirds of the savings in the fund which they have accumulated after 1 March 2021 to purchase an annuity, unless the total benefit is less than R247,000, in which case they can be paid the full amount as a lump sum.

2.2 Only retirement benefits are affected by these provisions. Members who leave service prior to retirement for any reason, whether retrenchment, dismissal or voluntary resignation can continue to elect to receive their full benefit as a lump sum.

2.3 Vested rights are protected. A member of a provident fund who is 55 years or older as at 1 March 2021 will not be affected by these provisions and can elect to receive his full retirement benefit in cash, as long as he remains a member of the same provident fund until retirement.

If a member who is 55 years or older on 1 March 2021 transfers to a new retirement fund before reaching retirement age, his contributions and the growth on such contributions until the date of transfer to the new fund will continue to be protected if the benefit is transferred to the new fund and he can elect to receive this amount as a lump sum on retirement. However, the retirement savings (contributions and growth thereon) accumulated after the date of his transfer to the new fund will be subject to the annuitisation provisions, which means that two thirds of this amount must be used to purchase an annuity.

2.4 The protection of vested rights also applies in the case of a member who is younger than age 55 years as at 1 March 2021.

The part of such a member's benefit attributable to contributions and any growth on the contributions accumulated prior to 1 March 2021 ('the vested portion') may still be paid out at retirement as a lump sum.

This part of the member's benefit must, therefore, be maintained in a separate account and the part of the benefit arising from the contributions and growth accumulated after 1 March 2021 and which is subject to annuitisation, must also be separately identified. However, tax will be payable on any amount paid to the member as a lump sum at retirement.

2.5 The protection of provident fund vested rights will continue to apply if a member of a provident fund transfers to another retirement fund or preservation fund after 1 March 2021. This means that on transfer to another retirement fund or preservation fund, the provident fund transferring the benefit must advise the transferee fund of the vested portion of the member's benefit so that this amount continues to be protected from annuitisation in the transferee fund.

2.6 Since the same tax dispensation now applies to pension and provident funds, transfers between the various vehicles for retirement funding will be tax free with effect from 1 March 2021. For example, tax was previously payable if a member transferred a benefit from a pension fund to a provident preservation fund. After 1 March 2021, this will no longer apply.

3. **What do boards of retirement funds need to do to prepare for 1 March 2021?**

3.1 Fund rules will need to be amended. Provident funds will need to amend their rules to separately identify the vested portion and ensure the rules allow for this part of the benefit to be paid as a lump sum at retirement. Both provident and pension funds have to amend their rules to allow for them to accept transfer of a benefit from a provident fund which contains part of the benefit recognized as a vested portion to ensure that the vested portion continues to be protected from annuitisation in the new fund.

3.2 Trustees would need to check with their administrators to ensure their systems are capable of identifying the vested portion of the member's benefit and ensuring it is protected from annuitisation.

3.3 Some employers operate both a pension and a provident fund. Such employers may want to rationalise these arrangements and save on costs by amalgamating the two funds.

3.4 Effective communication to members is essential. When these changes were first proposed in 2015, there was considerable resistance and suspicion of Government's intentions, with some members even resigning from employment in order to access their benefits.

Communication needs to be clear and in plain language that is easy for the member to understand. It is important to emphasise to members that only retirement benefits are affected and if they leave service prior to retirement they can still receive their benefit as a lump sum.

It is also important to communicate the concept of the protection of vested rights, that the process of annuitisation will be gradual and that current provident fund members may still be able to receive a substantial portion of their benefit in cash.