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TWO-POT SYSTEM LATEST DEVELOPMENTS

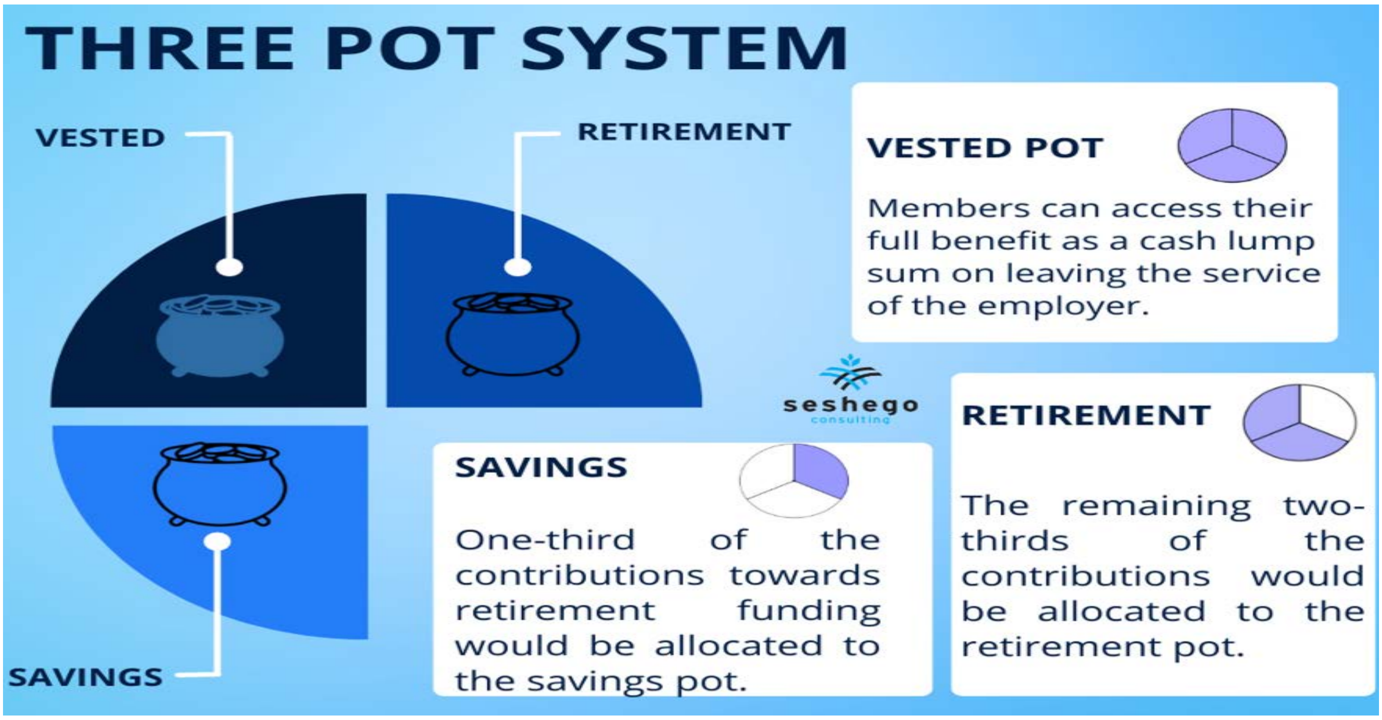
In case you missed it…

9. November 2022: Feedback from the Office of the Pension Funds Adjudicator
8. October 2022: Section 22 of POPIA Notification of Security Compromises
7. September 2022: Update on industry issues – FSCA requests to attend trustee Board meetings
6. July 2022: Revised Regulation 28 of the Pension Funds Act - Finalised
5. May 2022: Case Law – Decisions affecting Retirement Funds
4. April 2022: FSCA Conduct Standard
3. March 2022: FSCA Draft Strategy for Transformation
2. February 2022: Budget summary 2022/23 Tax Year
1. January 2022: Recent Papers issued by National Treasury

For details of National Treasury's original proposals, please refer to the January 2022 edition of Seshego Insights.

National Treasury ("NT") has not yet issued a formal statement on developments in their thinking with regard to the implementation of the "two-pot" system for retirement funds. The contents of this publication are therefore based mainly on what can be gleaned from media reporting of a statement by an official from NT which was made to Parliament in October 2022.

To recap, the system proposed by National Treasury actually envisages three pots – the "Vested Pot", the "Savings Pot" and the "Retirement Pot".



The vested pot would contain the member's accumulated benefit until the implementation date. Savings in the Vested Pot will still be under the rules of the previous dispensation and members can access their full benefit as a cash lump sum on retirement. After that date:

- One third of the contributions towards retirement funding (i.e excluding risk premiums and expenses) would be allocated to the Savings Pot. Members would be able to access a minimum of R2000 per annum from the Savings Pot without leaving the service of the employer. On retirement, the full amount in the Savings Pot, even if less than the R2000 minimum, could be taken in cash.

- The remaining two-thirds of the contributions would be allocated to the Retirement Pot. but the amount in the Retirement Pot would have to be preserved till retirement and then paid out as an annuity. However, NT's intention is that if the total amount of the member's savings in all three pots is less than R165 000, the current de minimis principle will still apply and the full amount may be taken in cash.

The following significant changes have been made to the original proposals as a result of pressure from the retirement industry and from COSATU.

1. Implementation Date

The implementation date has been changed from 1 March 2023 to 1 March 2024. COSATU would prefer an earlier date but the industry is adamant that even the date of 1 March 2024 may not afford it sufficient time to implement the major changes required. The measures retirement funds and administrators will need to take include the following:

- System changes and development of processes to accommodate the new system;

- Rule changes – a registered rule amendment must be in place allowing for the two-pot system, or the fund will lost its tax approval;

- Training of all staff involved in the process, including retirement benefits counsellors;

- Education of members. This is critical as media reports may have led members to believe they may have immediate access to their savings and it is important that members understand the conditions under which they will have a right to access retirement savings.

2. Allocation of Contributions

Previously NT proposed that *up-to* one third of retirement funding contributions would be allocated to the Savings Pot and the remainder would go to the Retirement Pot. The new proposals are as follows:

- All funds must provide for a Savings Pot and one-third of the contributions *must* be paid into this pot;

- Members will not be permitted to contribute less than a third of the contributions into the Savings Pot.

Further, it is compulsory for funds to implement the new system.

These proposals remove discretion from the trustees which is desirable, given the burden decision making on various issues imposes on trustee boards.

3. Other proposals

NT ***may*** consider allowing the following:

- Transfers from the Vested Pot to the Savings Pot, which is known as "seeding". This would enable members to reach the minimum of R2,000 more easily and therefore enable earlier access to their savings.

- Retrenched members to be able to access their benefits on leaving service. However, this would be under the following strict conditions

  - The member must have depleted all savings in the Vested Pot and the Savings Pot;

  - Any withdrawal must not affect the liquidity of the fund;

  - The member must have exhausted all UIF payments and have no other source of income.

  - Any amount paid out from the fund in respect of a retrenched member must be paid as an annuity, not as a lump sum.

4. Housing loans, compensation to the employer and divorce orders

There is still no clarity on how the permissible deductions from benefits provided for under the Pension Funds Act will be implemented, but it is likely that guarantees for housing loans in terms of Section 37D (1) (a), compensation to the employer in terms of Section 37D (1) (b) and payment to the non-member spouse in terms of Section 37D (1) (d) may not be taken from the Retirement Pot. The Pension Funds Act will have to be amended to make specific provision for this.

The Divorce Act refers to "*the benefit to which such a member would have been entitled … if membership of the fund would have been terminated on the date of divorce on account of his resignation from his office*". Many members will no longer be entitled to a benefit on resignation from employment and the Divorce Act will therefore also need to be amended.

5. Defined Benefit Funds

The two-pot system will apply to all retirement funds, including defined benefit funds and to funds such as the GEPF which are not currently registered under the Pension Funds Act. Defined benefit funds do not usually require contributions by the employer, so it is difficult to understand how contributions could be allocated between the Savings Pot and the Retirement Pot.

NT has as yet provided no guidance on how the system would work under defined benefit funds, but two methods are possibilities:

- The adjustment of pensionable service by the period equivalent to any amount taken in cash from the Savings Pot. This would require a complicated actuarial calculation.

- Rolling up amounts allocated to the Savings Pot on a defined contribution basis. Defined benefit funds often provide for amounts such as additional voluntary contributions to be dealt with in this manner.

The above is a brief summary of the main elements of the proposed system. There are other complexities, such as transfers between the pots and the taxation regime, but until NT provides clarity there is little point in detailed discussion of these issues at present. It is to be hoped that such clarity will be provided early next year, as even if the legislation is finalised before 1 March 2023, this will leave the industry with little time to make the major changes necessary before the system can be implemented. Seshego will communicate with clients once any further up-dates are provided by the authorities.

Should you have any questions regarding the above, please contact your consultant to assist you.