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Legal update 3 of 2022: Retirement reform update

Government introduces draft proposals for preservation of retirement savings that allow for limited access to retirement savings

The draft tax legislation containing the proposals on the so-called "two-pot" retirement system was issued for comments on 29 July 2022. In essence, with the two-pot retirement system, Government is proposing limited access to retirement savings without the member having to exit the fund, in exchange for compulsory preservation of the balance of the member's retirement savings until retirement.

National Treasury proposes that the two-pot system is implemented from 1 March 2023. This means that the new preservation and limited access rules will apply to all amounts contributed to the FundsAtWork Umbrella Funds from 1 March 2023. National Treasury did indicate the following in their media statement issued on 31 July 2022:

"The proposed 2023 implementation date is optimistic, because fund rules need to be changed, there will be systems changes within retirement funds to enable the two-pot system and SARS also needs to create capacity to cater for the new pots and track withdrawals. Furthermore, retirement funds must train employees, educate fund members about the reform and its implication."

For this reason, it's still likely that the implementation date could be postponed.

New savings pot, retirement pot and vested pot

From 1 March 2023, the FundsAtWork Umbrella Funds will have to provide for a savings pot, a retirement pot, and a vested pot for each member.

- The introduction of a savings pot will open the door for **early access to retirement savings**.
- The retirement pot will introduce Government's **new compulsory preservation rules** in that members will be unable to access any of the money in the retirement pot before retirement.

The vested pots will consist of members' retirement savings in the FundsAtWork Umbrella Funds accumulated up to 1 March 2023, plus any subsequent transfers to the vested pot from another vested pot, plus any investment growth on the amount in the vested pot. The full amount in the vested pot will be protected and the new compulsory preservation rules will not apply to this pot.

It's important that FundsAtWork members understand that if they change jobs on or after 1 March 2023, they will still be able to access the full value of their vested pots in the FundsAtWork Umbrella Funds.

Contributions to the FundsAtWork Umbrella Funds after 1 March 2023

Savings pot

A member will be able to choose how much of their monthly contribution amount is paid into the savings pot, but the amount will be limited to one-third of their total tax-deductible contribution. This limit to one-third of the total tax-deductible contribution means that a member cannot contribute more than one-third of an amount equal to 27,5% of their gross remuneration, or one-third of an annual amount of R350 000, to their savings pot. It also means that a member can opt that none of their contributions is paid into the savings pot, which would mean all of their contributions are rather paid into the retirement pot.

Retirement pot

The balance of the monthly contributions, in other words, the amount not paid to the savings pot, must be paid to the member's retirement pot. This will include any excess contributions the member makes above the tax-deductible amount.

Vested pot

Members will be unable to make any further contributions to their vested pots as all their contributions from 1 March 2023 will have to be paid into their savings and/or retirement pots. FundsAtWork Umbrella Provident Fund members who were 55 years or older on 1 March 2021 will be able to choose to contribute to their vested pots until they either transfer from the FundsAtWork Umbrella Provident Fund to another fund or retire.

Cash withdrawals from savings pot

A member can choose to take, in cash, the amount accumulated in their savings pot at any time if they need to. This allows members to make a cash withdrawal from the savings pot not only when they are in financial difficulty or changing jobs. These conditions will apply to cash withdrawals from the savings pot:

- limited to only one annual withdrawal, and
- a minimum withdrawal amount of R2 000.

The value of the withdrawn amount from a member's savings pot will be taxed at the member's marginal tax rate.

No immediate access to retirement savings

Members will be unable to transfer money from their vested pots to their savings pots. As the savings pot will start at zero on 1 March 2023, it will take some time for the amount in the savings pot to build up to the minimum amount of R2 000. For example, if a member earns R18 000 a month and their net retirement savings is R1 800 a month, the contribution to their savings pot will be a maximum amount of R600 a month, which means it will take the member at least 4 months to get to the minimum withdrawal amount of R2 000. **This means that members will not have immediate access to their retirement savings in the FundsAtWork Umbrella Funds on 1 March 2023.**

What will happen when a FundsAtWork member resigns after 1 March 2023?

Savings pot

If the member didn't make a cash withdrawal from their savings pot in the 12 months before the resign and if the balance in their savings pot is above R2 000, the member can take the full savings pot in cash, taxed at their marginal tax rate.

If the member made a cash withdrawal from their savings pot in the 12 months before they resign and/or if the balance in their savings pot is less than R2 000, the member can choose to:

- become a paid-up member of FundsAtWork Umbrella Fund, or
- transfer the savings pot partially or in full to their retirement pot in the FundsAtWork Umbrella Fund or in their new employer's fund, or
- transfer their savings pot to a savings pot or retirement pot in another fund.

The member will still be able to take the amount in their savings pot as a cash benefit after 12 months and/or once the amount is above R2 000.

Retirement pot

The member will not be entitled to any money in their retirement pot when they resign. They will have a choice to become a paid-up member of the FundsAtWork Umbrella Fund until death/retirement, or to transfer their retirement pot to a retirement pot in another fund. If they choose to transfer their retirement pot, they must also transfer their savings pot to the same fund as they will be unable to split the two pots between different funds.

Vested pot

When a member resigns, they will have the option to:

- take the full value of their vested pot in cash, which will then be taxed as a withdrawal lump sum, or
- become a paid-up member of the FundsAtWork Umbrella Fund, or
- transfer the vested pot to a vested pot in another fund.

What will happen when a FundsAtWork member retires after 1 March 2023?

Savings pot

The full value in the member's savings pot at retirement can either be withdrawn as cash, and taxed as a retirement lump sum, or be transferred to their retirement pot for buying an annuity.

Retirement pot

The member must use the full value in their retirement pot to buy an annuity. If the amount in the retirement pot is equal to or less than R165 000, the member can take the full amount in cash, which will then be taxed as a retirement lump sum.

Vested pot

The annuitisation tax rules that came into effect from 1 March 2021 will be apply to the vested pot. Please refer to Legal Update 1 of 2021 for a detailed explanation of the annuitisation rules. This means that the amount that can be withdrawn as cash will become available and will be taxed as a retirement lump sum, while the balance must be used to buy an annuity.

What will happen when a FundsAtWork member's South African tax residency ends, or their visa expires?

When a member has not been a South African tax resident for a period of at least 3 years and/or their visa has expired, they can withdraw the total amount of the retirement savings in their retirement, savings and vested pots. This is how the amounts in the different pots will be taxed:

- The amount in their savings pot will be taxed at the member's marginal tax rate.
- The amount in their retirement pot will be taxed according to the lump sum withdrawal tax tables.
- The vested pot will be taxed according to the tax rules applicable before 1 March 2023.

Auto enrolment

One of the proposals discussed in National Treasury's retirement reform discussion document issued in December 2021, is expanding retirement fund coverage by introducing so-called auto enrolment, or as an alternative, a mandatory retirement savings system. Government is proposing legislation to compel all employers to deduct contributions to an occupational fund or another fund for all their employees. National Treasury indicated that for now, its focus is on finalising the two-pot system and auto enrolment will only be considered after the two-pot system has been finalised.

Umbrella fund governance

National Treasury issued a discussion document in December 2021 on the governance of retirement funds in general and in particular commercial umbrella funds. While some commercial umbrella funds are well run, National Treasury is concerned about the potential consequences of poor governance in other funds. The intention is to propose how the governance of commercial umbrella funds can be strengthened. Please refer to Legal Update 1 of 2022 for a detailed discussion of the proposals. National Treasury indicated that for now, it's focusing on finalising the two-pot system and not on umbrella fund governance issues. But there is the possibility that umbrella fund governance will be consolidated into the Joint Omni-Governance Standard currently being developed by the Prudential Authority and the Financial Sector Authority, which will apply across all types of financial institutions.