# Two-Pot System
## FSCA

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# Background


- The proposed Two-Pot system (renamed the Two-Component system) is an important retirement reform aimed at addressing essentially two challenges:

  (1) **lack of preservation (pre-retirement leakage)**; and

  (2) **lack of access to retirement fund savings** in cases of emergencies by members who are in financial distress but who have assets within retirement funds.

- The access challenge became more pronounced during the Covid-19 pandemic; COSATU supported by FEDUSA called for members to have access to their retirement savings due to the dire financial position that they found themselves in. During the February 2021 Budget Speech and November 2021 Medium Term Budget Policy Statement (MTBPS) Speech, the Minister made an announcement of this intended retirement reform. These announcements were followed by a discussion document published by National Treasury (NT) on 15 December 2021, titled *'Encouraging South African households to save more for retirement'* for public comment.

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# Legislation

- After an intensive consultation process between National Treasury, Business and organised Labour (which included FEDUSA) where various risks, challenges and consequences were discussed, the culmination of this policy was reflected in the **Revenue Laws Amendment Act, 12 of 2024** (RLAA), which would, together with the Pension Funds Amendment Bill (PFAB), which is currently with the President for his assent, once enacted give effect to the Two-Pot system.
- Two-Pot system has application from 1 September 2024:
  - Savings Pot (one-third access pot) – available in case of emergencies once a year, minimum withdrawal R2000 (subject to normal marginal tax rates and admin costs); and
  - Retirement Pot (two-thirds compulsory preservation) – available upon retirement to purchase an annuity.

# Legislation cont.

- However, in reality, it results in the creation of three pots:
  - Savings Pot;
  - Retirement Pot; and
  - Vested Pot – vested rights/fund values (pre – 1 September 2024 fund credits)
    - Would not be impacted, hence, the creation of the third pot.

# Legislation cont.

- Seeding
  - The legislation provides for seed capital.
  - Maximum of 10% of fund credit as at 31 August 2024 capped at R30 000.
  - The seed capital is the amount that will be transferred from the vested pot to the savings pot on 1 September 2024 as an opening balance.
  - Intra-fund transfer.
  - This may be withdrawn from 1 September 2024 subject to your fund's/administrator's readiness and having obtained the tax Directive from SARS.

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# Examples

## Example 1:

Fund credit in vested pot as @ 31 Aug ‘24 = R250 000

10% allocated to savings pot on 1 Sept ‘24 = R25 000

Savings pot seed capital = R25 000

- Any withdrawal from the savings pot (including seed capital) will be subject to:
  - Marginal tax rate; and
  - Admin fees.

## Example 2:

Fund credit in vested pot as @ 31 Aug ‘24 = R1 000 000

10% up to R30 000 allocated to savings pot on 1 Sept ‘24 = R30 000

Savings pot seed capital = R30 000

- Any withdrawal from the savings pot (including seed capital) will be subject to:
  - Marginal tax rate; and
  - Admin fees.

# Examples cont.

## Example 3:

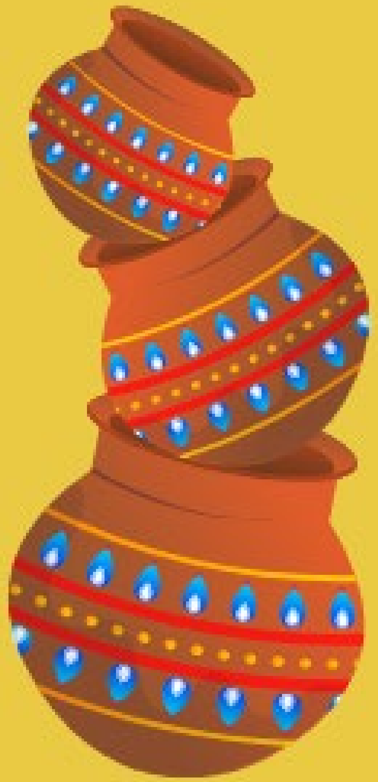
Fund credit in vested pot as @ 31 Aug ‘24 = R19 000

10% allocated to savings pot on 1 Sept ‘24 = R1 900

Savings pot seed capital = Does not qualify

- Less than minimum withdrawal amount of R2 000.

# Requirements for Two-Pot System



From 1 September 2024, all contributions paid to retirement funds (pension funds, provident funds, pension preservation funds, provident preservation funds or retirement annuity funds) must, in terms of the proposed amendments, be allocated to two different components, a retirement component and a savings component, which components must be established in the rules of the fund.

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# Savings Pot/Component

- A once-off amount of 10 per cent of the total value of the vested component (of each contract where members may have multiple contracts) in the fund as of 31 August 2024 limited to R 30 000 is to be allocated to this component on or after 1 September 2024 (the seeding capital);
- From 1 September 2024 one-third of the total net retirement contributions to a retirement fund must be allocated to this component together with fund return;
- Any amounts transferred from a savings component in another fund on or after 1 September 2024 may be allocated to this component if the member's total fund interest is transferred in terms of the rules of the fund.

# Savings Pot/Component cont.

The member may elect to transfer the member's interest in this component into the member's retirement component of the same fund.

Rules need to allow for a "savings withdrawal benefit", which is the portion of the member's savings component that the member may elect to withdraw prior to the termination of membership of the fund subject to such withdrawal being limited to:
(a) one withdrawal (per contract in a fund where there are multiple contracts in a fund) during a tax year and
(b) the value of each withdrawal not being less than R 2 000.

Provided that where a member terminates their membership in their respective funds within any year of assessment and such member has made a withdrawal from that fund and the value of the member's interest in the savings component is less than R 2 000, such member may be allowed a second withdrawal of the total balance in the savings component.

# Savings Pot/Component Withdrawal Examples

| | |
|---|---|
| Withdrawal amount = | **R30 000** |
| 18% Marginal Tax Rate = | **(R 5 400)** |
| Administration Cost = | **(R 500)** |
| Net amount = | **R24 100** |
| | **80%** |

| | |
|---|---|
| Withdrawal amount = | **R30 000** |
| 26% Marginal Tax Rate = | **(R 7 800)** |
| Administration Cost = | **(R 500)** |
| Net amount = | **R21 700** |
| | **72%** |

| | |
|---|---|
| Withdrawal amount = | **R30 000** |
| 31% Marginal Tax Rate = | **(R 9 300)** |
| Administration Cost = | **(R 500)** |
| Net amount = | **R20 200** |
| | **67%** |

| | |
|---|---|
| Withdrawal amount = | **R30 000** |
| 36% Marginal Tax Rate = | **(R10 800)** |
| Administration Cost = | **(R 500)** |
| Net amount = | **R18 700** |
| | **62%** |

| | |
|---|---|
| Withdrawal amount = | **R30 000** |
| 39% Marginal Tax Rate = | **(R11 700)** |
| Administration Cost = | **(R 500)** |
| Net amount = | **R17 800** |
| | **59%** |

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# Retirement Pot/Component


- From 1 September 2024, two-thirds of the total net retirement fund contributions are to be allocated to the retirement component together with fund return;
- Any amounts transferred from a retirement component in another fund from 1 September 2024 are to be allocated to this component;
- The total value of the member's interest in the retirement component is to be paid in the form of an annuity;
- Exceptions to paying an annuity: if below de minimis threshold, where the member is deceased/where member elects to transfer the retirement interest to another fund.

# Retirement Pot/Component

- The retirement pot will not have any money in it to start with.
- A member cannot make cash withdrawals from this pot.
- A member cannot have access to this retirement pot upon resignation/dismissal or retrenchment from employment, rather the benefit will have to be preserved.
- The amount must be used to provide an annuity subject to the *de minimis* amount of R165 000.
- The annuity will be taxed as and when it is paid to the pensioner.

# Vested Pot/Component


- Includes the value of the member's interest in the fund that exists immediately prior to 1 September 2024 together with fund return;
- The member's interest in this component, after taking into account the allocation of the seed capital to the savings component, must be paid in accordance with the rules of the fund that exist immediately prior to 1 September 2024;
- No contributions may be made to this component on or after 1 September 2024, save for arrear contributions and certain exceptions.

# Vested Pot/Component cont.


- Any amounts transferred from a vested component in another fund on or after 1 September 2024 are allocated to this component;
- The member may elect to transfer the value of this component into the member's retirement component of the same fund; and
- The regime in effect before 1 September 2024 will apply in respect of the vested component, which means that, for example, members will still be allowed to receive that vested benefit in cash on termination of employment before retirement.

# Transfers

- No transfers can be made into the savings pot save for the seeding amount.
- Members may transfer from the savings pot to the retirement pot.
- Transfers between savings pots or retirement pots are permissible across funds, however, if the savings pot is transferred to a new fund, the retirement pot is to be transferred together with the savings pot.
- All pots must be transferred together to a new fund when making the transfer upon termination of membership in the current fund.
- Transfers of vested pots subject to current rules.
- Transfers will remain tax neutral.


On liquidation of a fund, members may only access their retirement component on their retirement date. On liquidation the retirement component needs to be transferred to an approved retirement fund if the fund value/benefit is above the *de minimis* threshold. Funds are required to amend their rules to deal with liquidations.

# Application of two-pot legislation

- Application to all funds (DC) including Defined Benefit (DB) and Public Sector funds, save for the following exceptions:
  - Unclaimed benefit funds
  - Pensioners
  - Beneficiary funds
  - Closed/Dormant Funds
  - Legacy Retirement Annuity Funds may be exempted if it complies with the conditions to be determined by the FSCA.

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# Members of Provident Funds 55 and over on 1 March 2021

- Provident fund members who were 55 years or older on 1 March 2021 are exempted from these provisions, unless such member opts into the two-component system. Should this category of members opt into the two-component system, it is further required that they are still members of the same provident fund that they were in on 1 March 2021.
- Should these members not remain in the same provident fund that they were in on 1 March 2021, then such members are automatically on transfer in the two-component system.
- This category of fund members, who do not opt into the two-component system, have their benefits ring-fenced and these are regarded as vested benefits. Such members retain their rights to elect to commute their full benefit in cash and/or remain as contributing members according to the pre-1 March 2021 regime.


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# Defined Benefit Funds (incl. GEPF and other public sector funds)

- Must provide an opening balance for each member of up to 10% of the member's fund credit before 1 September 2024, capped at R30 000.
- If a part of the savings pot relating to the seed capital is paid to the member prior to retirement, the pensionable service of the member would need to be reduced.
- If a member decides to take a cash payment from the savings pot, the valuator will calculate the reduced pensionable service to determine the pension amount at retirement.
- Once the member has decided on the amount to be paid, the valuator will be required to calculate the service given up by the member representing the value of the cash payment made and the reduced pensionable service that will be available at retirement in calculating the pension.
- Should the fund wish to adopt a different methodology, this must be approved by the Authority in advance, whereafter this must be clearly set out in the registered rules to give effect thereto.

# Two-Pot System & the GEPF

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- From 1 September 2024, the Two-Pot System will apply to the Government Employees Pension Fund (GEPF).
- The Government Employees Pension Law, 1996 must be amended to give effect to the implementation of the Two-Pot System.
- Savings Pot (one-third of pensionable service) – Accessible once in a tax year.
- Retirement Pot (two-thirds of pensionable service) – Not accessible until retirement.
  - From 1 September 2024, for every year of future pensionable service, 4 months will be allocated to the Savings Pot and 8 months will be allocated to the Retirement Pot.
- Vested Pot (pre – 1 September 2024 pensionable service) – Accessible upon resignation / retrenchment. Calculation of the benefit will adhere to existing GEPF Rules.

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# Two-Pot System & the GEPF cont…

**15 years**

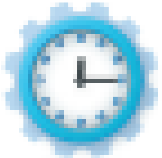
vested service

+

**4 months**

savings service

+



**8 months**

retirement service

**= 16 years** of total pensionable service

**A member** has 15 years vested service, 4 months savings service and 8 months retirement service. Such a member has 16 years of total pensionable service. Assuming that they have an actuarial interest of R873 000 and that they withdraw an amount of R18 150 from the savings pot. Such a member would lose 4 months of service from the savings pot. Hence after the withdrawal, the member would still have 15 years of vested service, no savings service and retirement service of 8 months. Such a member would now have actuarial interest of R854 850 and the total pensionable service would reduce to 15 years 8 months. The withdrawal has led to them losing 4 months of pensionable service. This will lead to them receiving a lower benefit in retirement than if they did not withdraw.

https://www.gepf.co.za/wp-content/uploads/2024/05/Two-pot-system-brochure-1-PRINT-READY.pdf

# Amendments to PFA and Public Sector Laws (in process)

## Amendments to PFA

- Includes new definition for "pension interest".
  - Recognises marriages concluded according to the tenets of a religion.
- It provides for the amendment of section 14B, which deals with members' individual accounts and minimum individual reserve
  - provides for the withdrawal from the savings withdrawal component in respect of both DB and DC funds.
- It provides for section 37D deductions across all 3 pots proportionately.
- Section 37D deductions include, *inter alia*:
  - divorce orders; maintenance orders
  - housing loans; damage caused to employer bro theft, fraud, dishonesty, etc.

## Amendments to public sector laws

- Apart from PFA requiring amendments to give effect to the two-pot system
- Amendments to various public sector laws are required:
  - ✓ Government Employees Pension Law
  - ✓ Transnet Pension Funds Act
  - ✓ Post and Telecommunications Related Matters Act

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# Practical Implications

- Requires system readiness.
- FSCA published Communication 3 of 2024 and Communication 16 of 2024 containing principles to be contained in the rule amendments for submission to FSCA.
- Rules submitted must only deal with the two-pot system.
- Communication to members is key.

# Member Communication

- These legislative changes and their impact on the value of members' benefits must be communicated to members in a simple, clear and comprehensive manner and must be timely and on-going as may be required.
- The communication should alert members to the impact that any withdrawal from the savings component will have on the value of the member's benefit. This can be done by way of illustration using examples.
- Withdrawals will have a deleterious impact on members' fund credits and is subject to tax and admin fees therefore only to be done in cases of  emergency.
- The FSCA may request a copy of the communication issued.

# Submission of Rule Amendments

- Funds and/or administrators may commence submitting two-component amendments from 2 May 2024 until 15 July 2024 to enable the Reviews and Authorisations Department to process and approve them timeously before the 1 September 2024 deadline.
- Processed on a first-come-first-serve basis.

# Other

- The rules of the fund must also provide how benefits will be impacted when a person ceases to be a tax resident.
- RLAB 2024 x2 to be published for comment.

# The End

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Financial Sector
Conduct Authority