fundtalk

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PENSION REFORM – THE TWO POT SYSTEM

Over the last few years, National Treasury has been working on introducing pension reform through the Revenue Laws Amendment Bill, and more recently through the Pension Laws Amendment Bill.

This reform introduces the Two Component system for retirement funds. However, for the sake of consistency and clarity, we will continue to use the term "Two-Pot system" throughout this document. The purpose of this article is to clarify how this system will operate for the GEPF and what it means for your retirement savings.

Rationale for the amendments

The proposed changes address two main challenges: first, the problem of not saving enough for retirement, and second, the difficulty people face when they need money urgently without risking their jobs. Currently, when people leave their jobs, they often withdraw all their retirement savings, which reduces their future income. Heavy taxes are meant to discourage this, but they haven't worked well enough. Also, people sometimes quit their jobs to access their retirement savings when they're in financial trouble, especially during crises like the recent pandemic and lockdowns.

The new amendments aim to encourage people to save more for retirement while giving them some flexibility to access their savings when they need to, without having to quit their jobs. This balance is important for long-term financial security.

What does the proposed two component system entail?

This system divides your retirement savings into two parts: a cash portion for immediate needs and a reserved portion for future retirement. This is different from the current system, which only has one part. Starting from September 1, 2024, any money you save/contribute for retirement or any benefits you earn in your retirement fund will be split into a Savings Pot and a Retirement Pot.

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Any retirement savings you've earned before 31 August 2024, won't be affected by the new rules and will stay in what is called a Vested Pot. A small part of your retirement savings earned before 1 September 2024, will be moved to the new Savings Pot. This amount is capped at either 10% of your benefits earned by 1 September 2024, or R30,000, whichever is lower. This initial transfer is called "seed capital" and will be available to you immediately from 1 September 2024. This transfer of seed capital will not be taxed.

A special feature of the new system is that you can now make withdrawals from the Savings Pot under certain conditions without leaving the fund. These withdrawals are called savings withdrawal benefits. However, it's important to know that each withdrawal from the Savings Pot affects your pensionable service, which in turn affects your eventual retirement benefits. Access to the Retirement Pot is restricted, as it must be preserved until you retire.

The Two-Component (Pot) system offers a balanced approach to retirement savings. It allows for immediate access to some savings through the Savings Pot while keeping the majority of your retirement benefits secure and growing over time in the Retirement Pot. This system aims to meet both short-term financial needs and long-term retirement security, adapting to members' changing circumstances.

What happens after 1 September 2024?

After 1 September 2024, all members will be automatically enrolled into the Two-Pot system, and no member can choose to opt-out, regardless of their age. However, pensioners are exempt from this system.

The benefits allocated to each pot will depend on your pensionable service. Every year, one-third of your pensionable service will go into the Savings Pot, with the rest allocated to the Retirement Pot. So, for every 12 months of service, 4 months will be allocated to the Savings Pot and 8 months will be allocated to the Retirement Pot.

Each member's pensionable service period will now be divided into three parts. For those who were members of the GEPF before 1 September 2024, there will be a Vested Service Period, which captures the period of service up to 31 August 2024. All GEPF members will now have a Savings Service Period, based on 1/3 of pensionable service from 1 September 2024, and a Retirement Service Period based on 2/3 of pensionable service from 1 September 2024.

Benefits will be notionally allocated to each pot, meaning there won't be a physical separation of assets. Each pot will have different levels of accessibility, as discussed below.

What is each Pot for?

The Vested Pot

This pot includes all benefits earned up to 31 August 2024. The allocation is based on service up to that date, final average salary, and actuarial factors. While the service component remains constant, the salary and actuarial factors may change over time, affecting the pot's balance/value. Access and taxation of this pot follow existing rules i.e. members can access it fully upon leaving their employer, with taxes depending on the reason for withdrawal (resignation or retirement).

A portion of retirement benefits earned before 1 September 2024 will be transferred as seed capital to the Savings Pot. Hence, the Vested Pot's balance on 1 September 2024 will be your total earned benefits at that date, less any seed capital transferred.

What is Seed Capital?

Seed capital is the portion of benefits earned before 1 September 2024 that will be immediately transferred from the Vested Pot to the Savings Pot. The amount is either 10% of a member's Vested Pot balance or R30,000, whichever is lower. This transfer from the Vested Pot to the Savings Pot will be once-off and will not be taxable. Let's clarify how seed capital will be determined using some examples.

Let's first consider a member whose total earned benefits as at 1 September 2024 amount to R500,000. These earned benefits of R500 000 are all allocated to the Vested Pot. The seed capital will be the lesser of 10% of R500,000 (R50,000) or R30,000. As 10% of the Vested Pot is higher than the cap of R30 000, the member can only transfer R30 000 as seed capital. The amount that is not seeded is retained in the Vested Pot as shown in the table below.

Description	Vested Pot	Savings Pot	Retirement Pot	Total Benefit
Before seeding	R500 000	R0	R0	R500 000
After seeding	R470 000	R30 000	R0	R500 000

As can be seen from the above, your overall benefit is unchanged. Your benefits are simply distributed differently across the three pots.

If the member's total earned benefits on 1 September 2024 had been R100,000 instead, then the seed capital would be the lesser of 10% of R100,000 (R10,000) or R30,000. As 10% of the Vested Pot is lower than the maximum of R30 000, this member can transfer the full R10 000 as seed capital. The member cannot transfer more than the calculated R10 000, as it would exceed the 10% limit set by legislation.

Therefore, the seed capital in this case is R10,000 as shown below.

Description	Vested Pot	Savings Pot	Retirement Pot	Total Benefit
Before seeding	R100 000	R0	R0	R100 000
After seeding	R90 000	R10 000	R0	R100 000

The Savings Pot

Starting from 1 September 2024, one-third of your accrued benefits from that date, will be assigned to the Savings Pot each year. Initially, there will be no balance in this pot (before seeding). However, there will be a one-time transfer allowed from the Vested Pot to the Savings Pot on 1 September 2024, giving members an initial balance. **This transfer won't be taxable.** Subsequently, one-third of your future pensionable service from 1 September 2024 will be allocated to the Savings Pot each month. It's important to note that only the initial transfer from the Vested Pot to the Savings Pot is allowed. Transferring funds from the Savings Pot back to the Vested Pot won't be possible.

Members can access the balance in the Savings Pot before retirement through savings withdrawals, subject to certain restrictions. To be eligible for a withdrawal, members must maintain a minimum balance of R2,000 in the Savings Pot. The maximum withdrawal allowed is the total balance available in the Savings Pot.

Example

Let's say you have R1,500 in your Savings Pot. According to the rules, you won't be allowed to make a savings withdrawal until the Savings Pot balance has grown to at least R2,000. Once your balance reaches R2,000 or more, you can withdraw any amount between R2,000 and the maximum available balance. For instance, if you had R50,000 in your Savings Pot, you could choose to withdraw any amount between R2,000 and R50,000. However, you wouldn't be able to request to withdraw less than R2,000 or more than R50,000 in this case.

Any amount not withdrawn in a year will be carried over to the next tax year. Members can make withdrawals from the Savings Pot once per tax year, starting from 1 March and ending in February of the following year. For instance, if a member withdraws funds on 5 September 2024, the earliest they can make another withdrawal will be 1 March 2025.

The Savings Pot will be accessible for all types of exits from the fund, and members can also make savings withdrawals. Importantly, members don't need to resign or leave the fund to access Savings Pot benefits, and no proof of financial distress is required. **However, withdrawals from the Savings Pot will reduce your eventual retirement benefits.** Each withdrawal will decrease your Savings Service period, affecting the benefits you receive upon leaving the fund.

Amounts withdrawn from the Savings Pot as savings withdrawal benefits, are considered additional income and will be taxed at your marginal tax rate in the year of assessment. When exiting the fund, benefits paid from the Savings Pot will be taxed according to relevant tax tables.

The Savings Pot is expected to provide you with a gratuity lumpsum when you eventually retire.

The Retirement Pot

Starting from 1 September 2024, two-thirds of the benefits earned based on your pensionable service, from that date will be allocated to the Retirement Pot. This pot aims to provide financial security for members during their retirement years. Withdrawals from the Retirement Pot are restricted and can only be made in the event of death, divorce, or retirement. Before retirement, no other withdrawals from the Retirement Pot are permitted.

The main purpose of the funds accumulated in the Retirement Pot is to establish a steady income in retirement. These funds are intended to support regular pension payments, ensuring a stable financial situation for members during retirement. However, there is an exception: if the balance in the Retirement Pot is R165,000 or less, members can withdraw the total amount as a cash lumpsum.

In the unfortunate event of a member's death, benefits from the Retirement Pot will be paid out to beneficiaries in the form of a lumpsum, as per current practice. Where eligible, surviving spouses will receive a regular pension payable for life. These payouts will be subject to taxation according to retirement tax table rates.

It's important for members considering emigration to note that the Retirement Pot will be inaccessible for three years following emigration. This measure is in place to preserve retirement funds within the Fund, aligning with the goal of providing long-term financial security for our members.

Benefits payable on exit

Upon exiting the fund, members will have access to the Vested Pot and Savings Pot, regardless of the reason for exit. However, the Retirement Pot will only be accessible upon retirement, in the event of a member's death, or in the case of divorce.

If a member resigns or is dismissed, they can only access the balance in the Vested Pot and Savings Pot as a lump sum. The Retirement Pot will only become accessible once the member retires. It will remain invested in the Fund (unless transferred to an equivalent Retirement Pot in another fund) and will be paid out as a regular pension upon retirement, except if the balance is below R165,000. In such cases, members will receive a lump sum payment.

Retiring members will receive payments from all pots. They will receive a gratuity from the Savings Pot and, to some extent, from the Vested Pot. Additionally, they will receive a regular pension from the Retirement Pot and partially from the Vested Pot. The table below summarises the accessibility of the different pots for each exit.

Exit Type	Vested Pot	Savings Pot	Retirement Pot
Resignation/Retrenchment/Dismissals	✓	✓	× (only payable on earlier death or eventual retirement)
Retirements_ (Normal, Early, Ill health and Late)	✓ (Meant to provide gratuity and pension benefit)	✓ (Meant to provide gratuity benefit)	✓ (Meant to provide pension benefit)
Divorce (ex-spouse entitlement)	✓	✓	✓
Transfers in and out of the GEPF	✓ (can only transfer to a corresponding vested pot of another fund)	✓ (can only transfer to a corresponding savings pot of another fund)	✓ (can only transfer to a corresponding savings pot of another fund)
Death	✓	✓	✓
Savings withdrawal benefits	×	✓ (balance should be at least R2 000.Only accessible once in a tax year)	×

How members can claim from the Fund

For standard exits like retirement or death, members can continue using the existing claims submission process, which many are already familiar with.

However, the process for savings withdrawals is still under development. This is because we're ensuring alignment with legal and regulatory frameworks, resilience to fraud and errors, and efficient handling of anticipated transaction volumes. Integrating this process with existing systems requires careful technological planning and testing to ensure security and a seamless experience for members.

Rest assured, the Fund is dedicated to providing clear, concise, and timely information. We'll notify all members as soon as the new process for savings withdrawals is finalised and ready for implementation. Our priority is to implement a secure and convenient system for smooth interactions with the Fund.

What members need to consider

We strongly advise members to keep their retirement savings invested throughout their entire retirement journey. Relying solely on the Retirement Pot may not ensure a comfortable retirement. Diversifying financial planning and having additional savings for emergencies separate from retirement benefits is highly recommended.

Consider the Savings Pot as a safety net for unforeseen circumstances, rather than a regular income supplement. Savings withdrawals should ideally be reserved for emergencies. It's important to understand the financial implications of withdrawals, including the tax liability and impact on gratuity and pensions at retirement.

Preserving retirement savings is crucial for a stable financial future. Early withdrawals not only reduce available funds but also impact pensionable service and gratuity benefits upon retirement. Approach retirement savings with a preservation mindset, considering the long-term effects of decisions.

Summary

The Two-Pot system introduced in pension reforms addresses challenges faced by retirement fund members in South Africa. It enhances preservation of savings while providing flexibility for those facing financial hardship, without needing to leave their jobs. The system offers a balanced approach, allowing immediate access to a portion of savings through the Savings Pot while securing and growing the majority in the Retirement Pot.

Members are encouraged to preserve retirement savings and consider long-term impacts. Diversifying financial planning ensures a stable and comfortable retirement while safeguarding the financial future. The Fund is committed to providing clear information and a seamless experience, with details on partial withdrawal procedures communicated as finalised.

it's important to note that the changes introduced by the new system are extensive and cannot be fully covered in a single article. Therefore, members should anticipate further articles and educational materials developed by the GEPF. We encourage all members to stay vigilant for upcoming communications from the GEPF regarding these important updates.