Trustee Tutor 18:
The two-pot system: perspectives and practicalities

With 1 September 2024 fast approaching, two-pot readiness is gaining momentum. The reality is that this major change impacts every role player in the industry and every person involved with retirement funds – no matter what their function is. This issue of trustee tutor looks at the practical implications of the two-pot system from the perspectives of all involved.

Pension and provident funds, preservation funds and retirement annuity funds are required to comply with the two-pot regulations.

A summary of the two-pot system

From 1 September this year, any contribution that is paid into a retirement fund will be split between a member's:

⅓ **savings** pot

- Will grow with transfers in from other savings pots and investment return.
- Access once a tax year whilst in service. (R2 000 minimum withdrawal amount.)
- Withdrawn amounts taxed at member's marginal rate.

⅔ **retirement** pot

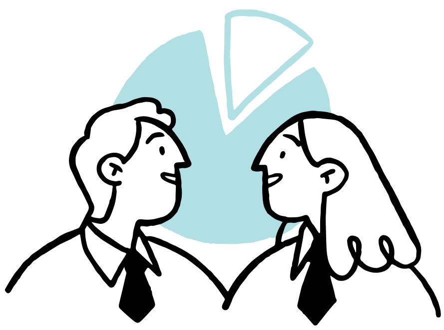
- Will grow with transfers in from other retirement pots and investment return.
- Saved until member's retirement or death – no withdrawals allowed.
- Must be annuitised in full on retirement.

A member who belonged to the fund before 1 September 2024, will also have a vested pot.

Fund value @ 31 Aug '24
vested pot

- Will grow with transfers in from other vested pots and investment return.
- Member can't access while in service.
- Subject to existing fund rules.

On 1 September 2024, 10% of the member's vested pot (subject to a maximum of R30 000) will be transferred to his or her savings pot.



How are benefits paid from each pot?

Savings withdrawal benefit

- Withdrawal can be made once every tax year while employed
- Minimum withdrawal amount is R2 000, maximum is total value of savings pot
- Paid from savings pot
- Fully taxed at member's marginal rate
- There may be an admin fee
- No reason needed when taking a savings withdrawal benefit

Withdrawal benefit

- Paid on termination of employment
- Everything in savings pot can be paid in cash (if no withdrawal taken in that year). This will be taxed at member's marginal rate.
- Nothing from the retirement pot can be taken in cash
- Everything in vested pot can be paid in cash. This is taxed in terms of the withdrawal lump sum tax tables
- After taking cash, the remaining pots must be transferred out of the fund or stay in the fund (not a combination of both)

Retirement benefit

- Everything in savings pot can be paid in cash or transferred to the member's retirement pot and annuitised
- Total balance in retirement pot is paid as an annuity
- Vested pot can be paid as part annuity and part cash depending on annuitization vesting/non vesting amounts
- Cash taken is taxed in terms of the retirement lump sum tax tables

Important note: members who were 55 years old on 1 March 2021

The two-pot summary applies to all members who were under the age of 55 on 1 March 2021 (T-day).

Members who were 55 years or older on 1 March 2021, have 12 months from 1 September 2024 to choose to be in two-pot or opt out.

The purpose of this trustee tutor is not to debate the merits of the two-pot system. By and large, however, the retirement fund industry does support this as a positive step which will ultimately lead to higher preservation rates in the long term.

Now that we understand how the two-pot system works, let's look at how this affects all of us involved in the retirement funds industry.

The board of trustees/the fund

The two-pot system is a fundamental overhaul of our retirement funding system. Trustees need to make sure that they and the funds they manage, are prepared.

Training and understanding. Trustees must understand the two-pot system and its impact on each aspect of the retirement fund. This is a relatively technical piece of legislation, and one that will impact every member of the fund, as well as the service providers to whom the trustees outsource many of the fund's processes. Training on two-pot is a must if trustees are to carry out their fiduciary responsibilities with care and diligence.

Will the employer be ready? Members usually raise their queries and concerns with their human resources or salaries departments. Trustees would be well served to check in with these departments to make sure they are well trained to deal with any queries that may be expected and the potential influx of claims.

Understanding the practical implications for the fund. Trustees should have a broad appreciation of how many fund members will meet the R2 000 minimum savings withdrawal on 1 September 2024. They can then make some assumptions on how many claims to expect.

Will the fund's service providers be ready? Trustees should regularly follow up with their service providers to track progress towards day 1 readiness. Service level agreements may need to be amended.

Negotiate fees. The payment of claims whilst members remain in employment is a new process that has not been previously factored into providers' fee scales. These fees need to be agreed and incorporated into relevant service level agreements.

Rule amendments need to be registered. In order to have the necessary amendment registered before 1 September, these need to be lodged with the FSCA by the end of July 2024. To facilitate the process, the FSCA has advised funds to only include the necessary two-pot changes in their rule amendment, and not any other rule provisions the trustees may want to amend..

Specific two-pot member communication. Sufficient and meaningful member education is key to a successful implementation of two-pot in the fund. A member communication campaign should include the impact of the two-pot system on members' benefits, the financial consequences of taking early withdrawals and the processes to follow when submitting a claim. Managing members' expectations around the timing of payments is very important.

The rest of the fund's communication material needs to be reviewed to ensure that it aligns with the new structures, for example, benefit statements and member booklets.

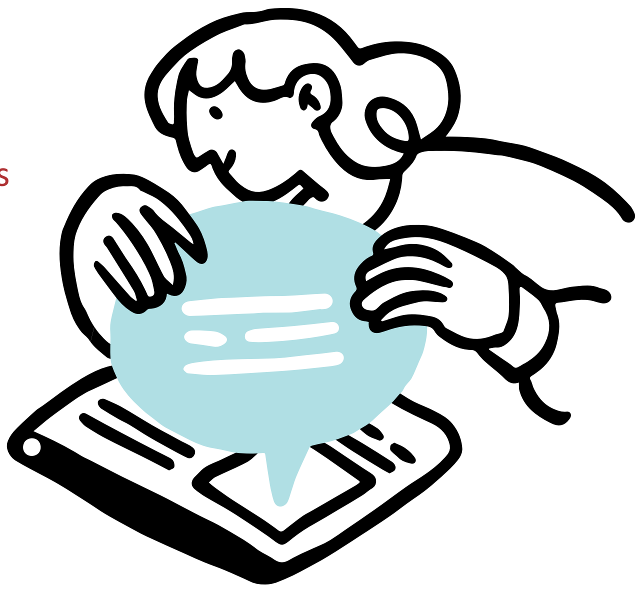
Consider the fund's investment strategy. It is difficult to predict how many members will access their savings pots, and how often. At this stage, trustees should discuss whether there is any need to have a different investment strategy for the different pots – as each pot has a different investment time horizon.

Cash outflows in September. Some trustees are concerned about the number of withdrawals they should expect in September 2024, and whether their retirement fund could run into liquidity problems. Raise any concerns with the fund's investment managers and consultants.

Risk management framework. This new retirement regime may introduce new risks to the fund and its service providers. Trustees should review their risk management processes and policies to make sure that all the risks have been considered and appropriate risk mitigation measures are in place.

Fund accounting considerations. Trustees should confirm with the fund's auditors whether there will be any additional accounting considerations, especially regarding additional disclosures, particularly for funds with a September year end. This may include the need to highlight subsequent events, the potential impact of the system on changes in accounting policies, any contingent liabilities etc.

The two-pot system is a complete overhaul of South Africa's retirement funding landscape, one which is expected to bring about better retirement outcomes in the long term. Trustees are key decision makers in ensuring a smooth implementation of these changes and must ensure they understand the law and the processes needed to implement it.



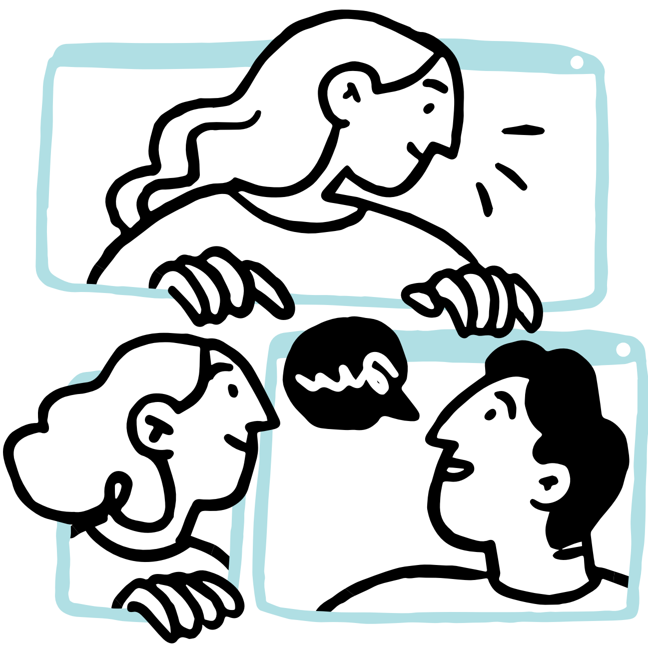
Retirement fund members/employees

Members are arguably one of the key stakeholders in the fund. The two-pot system brings about significant changes to their retirement benefits and their long term financial planning. The aim of this system is to provide members with a balance between short term financial flexibility and long term retirement security.

This balance brings with it both opportunities and challenges for fund members. On the one hand, to be able to withdraw a portion of their retirement fund during times of financial hardship or in emergencies can provide much needed financial relief when members need it the most. What is the point of having a big retirement fund in 25 years' time, when you can't repair the tyres on your car right now to safely drive your children around? However, repeated withdrawals for frivolous spending could erode the member's retirement security.

So how do members make the most of this new system that is designed ultimately for their benefit?

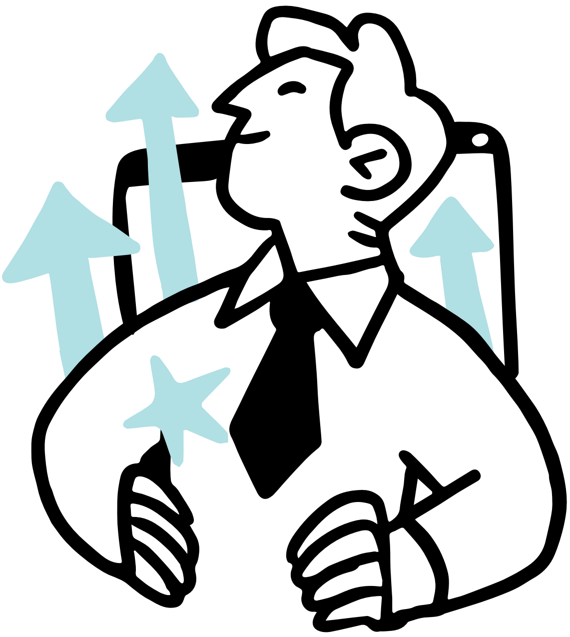
- **Stay informed.** In the past, most members only interacted with their retirement fund when they left employment and took their money out of the fund. From 1 September, however, they will have the opportunity to interact with the fund on a far more regular basis. This hopefully will result in a greater investment of attention into the benefits the fund provides and how they are able to maximise those benefits for their unique financial situation. Members must read the communication the fund provides.
- **Understand the rules of the two-pot system**, particularly when it comes to how the savings pot will be seeded, and how much money is available for immediate withdrawal. Some members will not qualify for any withdrawal benefits come 1 September.
- **Follow the correct process in submitting withdrawal claims.** There is expected to be a spike in savings withdrawal claims as the new legislation comes into effect in September. Members must make sure that they follow the correct process to submit their claims and remain realistic in their expectations as to when they will receive their payments.



- **Keep tax affairs up to date**. All savings withdrawal benefits will be taxed at the member's marginal tax rate. In order to process a savings withdrawal claim, the administrator will need to apply for a tax directive. If a member's tax affairs are not up to date, there will be delays in payments.
- **The tax impact of savings withdrawals**. Withdrawals made from the savings pot prior to retirement are taxed at marginal rates, whereas retirement benefits are taxed according to a more favourable tax table. Thus, members pay higher tax on their savings withdrawal benefits than they would should they only take the money when they retire.
- **Being pushed into a higher tax bracket**. The money withdrawn from the savings pot will be added to a member's income and taxed at their marginal rate. This may push the member into a higher tax bracket.

- **The loss of compounding on withdrawn amounts**. Once the money is withdrawn from the fund, members lose out on the compounding effect of investment returns on that money for the remainder of the time until retirement. This compounding could be significant.
- **Members may pay a fee for their withdrawals.** Members must be prepared that tax and fees will lower the amount they receive when making a savings pot withdrawal.

With the flexibility introduced by the two-pot system, comes the responsibility for members to seek proper financial advice to make sure they understand the consequences of the decisions they are making.



Administrators

Two-pot places a significant administrative burden on the fund and particularly its administrators.

- **The administration of all the pots.** Administrators need to ensure that their administration systems are able to administer all the pots, allocate monthly contributions correctly as well as manage the different tax applications of each pot. If one considers that many fund members will have vested pots, a portion of which will be prior to 1 March 2021 and a portion after 1 March 2021 (T-day changes), and contributions are now to be split between various pots, together with seeding amounts that need to be transferred into savings pots on 1 September 2024, one appreciates the systems capabilities needed to keep accurate fund records.
- **Increased queries.** Like the employer's human resources and salaries departments, it is expected that members will raise many queries directly with their fund administrators. Administration and call center teams may need to be bolstered with additional staff.
- **Increased claims.** Administrators are generally resourced to deal with members only lodging one claim during their fund membership. In other words, members have only accessed their retirement benefits once – when they left the services of their employer. From 1 September, however, members may claim once every year. This will have an impact on the administration services and resources required. If not done already, claims processes themselves should be digitised and streamlined to alleviate some of the increased burden on administration staff.
- **Regular training**. Administration teams need to be trained on both the legislation itself as well as the system changes done to accommodate two-pot. Processes, like monthly contribution reconciliations, will also change and administrators must be upskilled on these.
- **Forms need to be updated.** The relevant administration forms need to be updated to take into account savings pot withdrawals.

- **Online tools need to be reviewed.** Most administrators these days offer members online access to their personal fund details and values. In many cases this also comes with various tools to enable the member to plan for his or her retirement. These tools need to be reviewed to take into account any withdrawals before retirement, as well as the compulsory saving of the retirement pot.
- **Be vigilant for increased fraud.** As the opportunity for members to access their funds annually becomes a reality, so does the possibility of increased fraudulent claims.
- **An influx of visitors to the administrator's offices.** Administrators should be prepared for an increase in the number of members approaching their offices directly. Members may wish to lodge manual savings withdrawal claims, or express their unhappiness at not being able to claim due to insufficient funds in their savings pots, or to complain about the time taken to process their claims. Receptionists, walk in centers and security staff need to be briefed and prepared on how to deal with the potential crowds that may arrive on 1 September 2024.

There is no denying that the two-pot system has arguably the biggest impact for retirement fund administrators, as they need to understand the law and administer it effectively. This requires significant training, investment in resources, capable systems and streamlined processes.

The employer

As we've mentioned already, the employer's human resources and/or salaries departments will be one of the main points of contact for members. It is expected that these people will get many questions around how much money a member can access as well as how to go about claiming this money.

- **Training**. Human resources and salaries staff require a high level understanding of the two-pot system and how it works, together with a much more in depth knowledge of the processes involved in claiming.
- **Online access to members' values**. It is anticipated that the majority of initial queries will center around how much a member is able to access. For the employer to be able to access these values online, will alleviate much of the run around between employers and administrators.
- **Correct contribution schedules.** It is crucial that employers submit their monthly contribution schedules per their administrator's requirements. The information required in these schedules is vital in ensuring the smooth administration of the two-pot system.

The employer is a key point of contact. Make sure they are trained on two-pot and that they follow their administrator's contributions and claims processes.

Personal financial advisors

Financial literacy is becoming an industry imperative. Now more than ever, members of retirement funds need to make sure they are advised by an accredited financial advisor.

- **Asset allocation.** The combination of different pots with different rules, with varying rates of taxes charged on different withdrawals, can create confusion and complexity. For financial advisors, this is an excellent time to explore the most appropriate asset allocation with clients, ensuring this aligns with the intent of the different pots.
- **An increase in the number of client meetings.** The two-pot system provides another opportunity for financial advisors to interact with their clients and to plan their overall wealth strategy. Clients need to understand the long term financial consequences of accessing their savings pots and, where they do make a withdrawal, that the money is used for emergencies only.
- **Be prepared to educate individuals.** In meetings, financial advisors should be prepared to discuss the tax implications of any withdrawals a client is considering, as well as the impact of withdrawals on the amount they will have in the fund when they reach retirement.
- **Helping clients manage debt effectively.** Financial advisors should explore alternative ways of settling debt, for example debt consolidation, access bonds on home equity and effective budgeting, before using the client's savings pot in their retirement fund.

The value of financial advice is becoming more and more important. Individuals need to understand the benefits their retirement fund provides in the context of their overall financial plan. Accessing their savings pots will have consequences down the line.

There is no doubt that the two-pot system will impact every stakeholder's roles and duties in the retirement industry. It is imperative that all those around the table understand the part they play in its smooth implementation and act with confidence and care. Underlying a successful implementation is making sure that members understand the new law and are equipped to make the best possible decisions for their financial future.

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For an on-line version of the required reading material as well as electronic CPD Submission form, go to https://www.pensionsworldsa.co.za or https://www.ebnet.co.za

How to?

Answer all the questions by inserting the correct answer(s) into the block provided next to each question, scan the pages and email to Toni Cantin at ICTS, using cpd@icts.co.za

1. The two-pot regulations will apply to:

a. Pension funds ☐
b. Provident funds ☐
c. Preservation funds ☐
d. All of the above ☐

2. For the vast majority of retirement fund members, on 1 September 2024, they will in fact have three pots.

a. True ☐
b. False ☐

3. On 1 September 2024, a member's savings pot will receive an amount of:

a. 10% of their retirement pot, subject to a maximum of R30 000 ☐
b. 10% of their vested pot, subject to a maximum of R30 000 ☐
c. 20% of their retirement pot, subject to a maximum of R25 000 ☐
d. 20% of their vested pot, subject to a maximum of R25 000 ☐

4. After 1 September 2024, any member who resigns from his or her employer can take the following in cash:

a. Their full vested pot, savings pot and retirement pot. ☐
b. Only their full savings pot. ☐
c. Their savings pot (assuming they have not taken a withdrawal in that tax year) and their vested pot. ☐
d. Their savings pot (assuming they have not taken a withdrawal in that tax year) plus one third of their retirement pot. ☐

5. Who has the option to opt in to the two-pot system?

a. Members who are aged 55 on 1 March 2021. ☐
b. Members who were aged 55 on 1 September 2021. ☐
c. Members who were aged 55 on 1 March 2024. ☐
d. Members who are aged 55 on 1 September 2024. ☐

6. Boards of trustees need to consider the following when debating the two-pot system's implementation:

a. How it will affect their risk management framework. ☐
b. How to best communicate to and educate members. ☐
c. Whether all the fund's service providers will be in a position to provide the services required on 1 September 2024. ☐
d. All of the above. ☐

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7. Members don't need to update their tax details as no tax will be applied on any savings withdrawal benefits.

a. True ☐
b. False ☐

8. _________ need to make sure that all the forms are updated to cater for the two-pot system:

a. Employers ☐
b. Management committees ☐
c. Administrators ☐
d. Financial advisors ☐

9. It is the role of the _________ to make sure that contribution schedules are submitted with the full information required by the fund administrator, following the correct process.

a. Trustees ☐
b. Employer ☐
c. Financial advisor ☐
d. Members ☐

10. The two-pot system affects every stakeholder in the industry. Thus, ___________, is crucial to facilitate its smooth implementation.

a. Ongoing training and education. ☐
b. Credible financial advice for members. ☐
c. Well equipped administration teams to deal with the expected increased queries and claims. ☐
d. All of the above. ☐