Is the new retirement system applicable to defined benefit funds?

10 October 2023

According to the National Treasury, the implementation of the two-pot system will affect all retirement funds, including defined benefit funds.

Many public sector funds are defined benefit funds whilst most private sector funds are defined contribution funds.

Public sector funds are defined in the Income Tax Act and include the following:

- Retirement funds that are not the GEPF such as municipal funds;
- Any pension fund established for employees of a control board as defined in the Marketing of Agricultural Products Act or for employees of the Development Bank of Southern Africa;
- Any provident funds established for employees of municipal entity funds created under the Municipal Systems Act and
- The Government Employees Pension Fund.

The GEPF is also defined as a pension fund in the Income Tax Act.

The difference between defined benefit funds and defined contribution funds	
Defined Benefit Funds	Defined Contributions Funds
The value of the benefits at retirement is determined by a formula contained in the fund rules and does not depend on how much the member or employer have contributed.	The retirement benefit is equivalent to the total retirement fund value which consists of the accumulated member contributions, employer contributions and investment returns.
The employer carries the investment risk.	The member carries the investment risk.
The retirement pension must be provided by the fund regardless of fund performance.	The income the member will receive during retirement will depend on the investment returns of the fund.

The GEPF is governed by the Government Employees Pensions Law and is a defined benefit fund.

It is our understanding that the GEPF has begun informing its members that the two-pot system will also impact them.

With effect from 1 September 2024, defined benefit funds will be required to calculate the contributions differently compared to the calculation used for a defined contribution fund. One-third of the contributions will be allocated to a "savings component," based on one-third of a member's pensionable service, while the other two-thirds will go into a "retirement component," based on two-thirds of their pensionable service.

In a defined benefit fund, where the retirement benefit is based on a formula that depends on factors like the members pensionable years of service and final salary, annual withdrawals and the seeding of capital will also be calculated differently. The calculation implies that for defined benefit funds, allowing for withdrawals, will involve a reduction in the member's retirement benefit, which will be achieved by reducing the member's years of service. Seeding will be calculated in the same way through a past service adjustment.

The highlights of the message from the GEPF to their members are provided below. Please take note that this is purely based on the information presented to a group of GEPF members by the Fund itself recently and we cannot provide any further detail or confirmation.

Vested Component	Savings Component	Retirement Component
The value of the vested component will be based on pensionable service up to 31 August 2024.	The Fund will calculate the value of one-third ‘contributions’ on behalf of the member, based on one-third of the member’s pensionable service.	The Fund will calculate the value of two-thirds ‘contributions’ on behalf of the member, based on two-thirds of the member’s pensionable service.
The value in this component will not be a final value, as it will change along with any changes to a member’s final salary.	Members will have an option to seed their savings component with 10% of the value in their vested component (to a maximum of R30 000) on 1 September 2024.	
	Members will be allowed to take a withdrawal once per tax year, subject to tax, and if the balance in the savings component is at least R2 000.	

Any withdrawals done will result in a reduction in the pensionable service recognised for the savings component.

Resignation currently means that the member is entitled to their full actuarial interest, but actuarial interest equates to the sum of all three components. Under the new system, the actuarial interest available upon resignation will only be equal to the value in the vested and savings components. The value in the member's retirement component will be preserved and only available at retirement or death. Upon the death of a member, any service adjustments made to accommodate the new system, will be taken into consideration. When a member retires in the Fund, the current structure of the benefits will not change, except that service adjustments are yet again taken into account.

Member benefits are still based on both pensionable service as well as salary.

Implementing the new retirement system for defined contribution funds is a complex matter. Sanlam Corporate have provided a view on this, confirming that they expect several administrative complexities and inefficiencies as well as a significant cost increase in delivering administration services in terms of this proposal, both from an actuarial and administration perspective for the following reasons:

- The Actuary will have to calculate the seeding capital to be allocated to the savings component on 1 September 2024, which is a compulsory event;
- The Administrator will have to keep a record of the value of the seeding capital;
- The Actuary may have to calculate the contribution allocation with each contribution cycle;
- An actuarial calculation will be required to determine the value in the savings component with each annual cash withdrawal from this component and
- Each Fund withdrawal, whether it is a resignation or retirement, must make provision for the determination of the value of the vested, savings and retirement components.

Overview on the Two Pot Retirement System in the GEPF context. *www.gepf.co.za - 26 January 2024*
GEPF and other public sector funds 'will be part of the two-pot system'

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