Retail Affluent: Sanlam Risk and Savings

The two-pot retirement system

More on what it is about

The two-pot retirement system, expected to come into effect on 1 March 2024, will bring about a major change in the current way of saving towards retirement. It will arguably be one of the most significant changes for the industry and clients alike since the introduction of retirement annuities. This article unpacks what it is about and what is important for you to take into consideration in the months ahead.

The purpose of the two-pot retirement system

The South African retirement fund system has undergone fundamental reforms over the past decade in an attempt to align the various retirement fund vehicles available to individuals.

There are two primary concerns about the design of the current retirement system:

- The first is the lack of preservation before retirement where individuals can access their institutional pension and provident funds in full when changing or leaving employment. Access to retirement annuity funds is prohibited until age 55.
- The second issue is that some households in financial distress do not have alternative financial resources other than retirement fund benefits that are not readily accessible – a dire situation highlighted by the Covid-19 pandemic during which many saw their income reduce or even disappear completely.

The new retirement system aims to strike a balance between helping South Africans preserve their retirement savings until retirement and providing access to emergency funds in times of financial hardship while they are still employed and belonging to a retirement fund.

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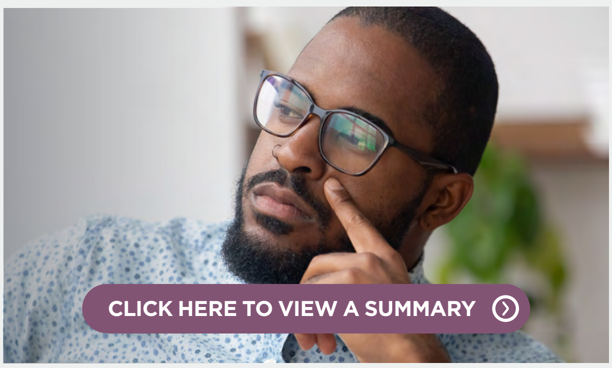
How the two-pot retirement system will work

The two-pot retirement system will apply to all retirement funds i.e. pension, provident, retirement annuity and preservation funds. Under the new retirement system, contributions will be allocated to separate components (also referred to as pots). However, contributions will still be administered per individual investment or retirement annuity plan and not per component.



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Financial advice is critical to navigate this new landscape

Your role as a financial advice partner will be crucial in educating and encouraging clients to view access to the savings component as a last resort option, and not the money to dip into first. Clients must understand the purpose of the two-pot retirement system and how it works to ensure that they are well informed to make financially sound decisions. They will rely on you to help them navigate this new landscape – helping them realise the importance of saving for retirement and preserving their retirement savings.

Your advice can assist them in reprioritising their goals and managing their short- as well as long-term savings options in the most tax-efficient way. Not only are the tax implications of considerable importance if they want to access the savings component, but they should also understand that it will be very difficult to get their retirement savings back on track if they make cash withdrawals.

CLICK HERE TO SEE HIGHLIGHTS

This is not the money to dip into first – here's why

Withdrawing a portion of their retirement savings before they reach retirement may provide clients with short-term relief in case of financial hardship, but it will have immediate tax implications as well impact their long-term financial retirement goals in more ways than one.

Income tax will be deducted from the withdrawal amount

The amount that clients withdraw from the savings component before retirement will be added to their taxable income in that tax year and as such will be taxed at their marginal tax rate of anything between 18% and 45%, depending on their tax bracket. There is no tax relief for withdrawals from the savings component while, if retained until retirement, the first R550 000 of any lump sum payouts on retirement is currently tax free.

The withdrawal amount will reduce the cash lump sum at retirement

Clients must also remember that early withdrawal of any part of their savings component means they will have less cash available as a lump sum when they retire. This part of their retirement benefit is important because they may need cash to cover one-off expenses such as settling debts.

CLICK HERE TO VIEW AN EXAMPLE TO ILLUSTRATE THE IMPACT OF A WITHDRAWAL FROM THE SAVINGS COMPONENT.

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What to expect next

The current timelines communicated by National Treasury seem to suggest that the promulgation of the two-pot retirement system will only happen sometime after October 2023 for the 1 March 2024 effective date. The new retirement system poses unique challenges to the administration of retirement savings products.

Within the challenging timelines as well as waiting for the final legislation, we have been (and still are) putting in a considerable amount of effort to ensure the readiness of all our systems and processes to administer retirement savings products according to the new retirement system and to process withdrawal requests.

In conclusion

We believe that the introduction of the two-pot retirement system may benefit a lot of people and will contribute to achieving much better long-term retirement outcomes. We are dedicated to helping our financial advice partners and clients understand the new retirement system – to enable them to live confidently, knowing that every educated financial choice they make will set their future selves up for success while addressing current financial needs.

We will provide regular updates prior to 1 March 2024. Comprehensive workshops to unpack the two-pot retirement system will be facilitated by our regional product specialists during the first quarter of 2024 and will include detailed support material to enable you to confidently support your clients in terms of the new system.

If you have any questions in the interim, you may direct them to your regional product specialist.

This intermediary article forms part of Sanlam's ongoing support to intermediaries. It does not constitute advice by Sanlam. The details about the two-pot retirement system in this intermediary article are based on the 2023 draft amendment bills. Some aspects may change during the consultation and parliamentary process that will still be followed prior to the finalisation of this legislation.

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