Two-pot system: Parliament's decision sparks industry consternation

By Richard Firth

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The recent announcement that Parliament's standing committee on finance has declined to extend the implementation date of the two-pot retirement system to 2025 has been met with consternation by many in the industry.

Source: 123RF.

With reactions ranging from condemnation of the new structure to concern about the ability of financial service providers to implement the changes in good time, experts, advisors, and authorities have voiced a number of questions about how the legislation will be executed.

Despite the fact that the two-pot retirement system was first proposed in February 2021, the regulations have yet to be ironed out, leaving the industry with queries around technical details like tax scales and draft rules.

At the time the Bill was published, the plan was initially for the amendments in the Bill to take effect on 1 March 2023. This was changed to 1 March 2024 by National Treasury, with draft legislation expected to be published for comment prior to this date. Unfortunately, this has not yet happened, leaving pension fund and retirement annuity managers in the unenviable position of trying to comply with incomplete legislation.

This was acknowledged in the 2023 Budget Review, with specific areas being highlighted as needing additional work. These include a proposal for seed capital, legislative mechanisms to include defined benefit funds in an equitable manner, as well as legacy retirement annuity funds and withdrawals from the retirement portion if one is retrenched and has no alternative source of income.

The plan is to address any gaps in the draft legislation over at least two implementation phases.

There are actually three pots

In light of the legislative challenges around the two-pot retirement system, the obvious concern is whether companies will have sufficient time to prepare. The proposed scheme is different enough to the current system that a great deal of work will have to be done to ensure that fund managers are able to not only pay out part of the one-third saving amount if requested, but to educate clients around the intricacies of having multiple "pots".

As the legislation is currently planned, it will be compulsory for all retirement funds to split contributions between a savings and a retirement "pot". One-third of contributions will be allocated to the savings pot, which will allow policy holders to access funds at any time, subject to some limitations. Whatever is left in this pot at retirement will be available as a cash lump sum.

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The remaining two-thirds will be allocated to the retirement pot, which cannot be accessed until retirement. Currently, when an individual resigns from their job or is retrenched, they are able to withdraw the full balance of their savings in the fund, subject to tax. Under the new legislation, policy holders will be forced to preserve their retirement funds and use the full amount to purchase an approved income product.

Contributions made up until the implementation date, plus all growth on those contributions, will remain in the existing or "vested pot". These contributions will still be subject to all the rules and entitlements that apply today.

For example, provident fund members who were over 55 on 1 March 2022, when the previous round of changes to the legislation was implemented, do not have to annuitise when they retire. These individuals will not be forced to allocate two-thirds of their contributions to a pot which has to be annuitised at retirement, but they will be given the option to do so.

Local expertise will win the day

Implementing this multi-pot system will require a complete overhaul of fund managers' back-end systems, and while many have started this process, others will struggle to meet the 2024 deadline. Those that use local systems providers will have an advantage over companies that rely on international software.

Local systems providers like MIP Holdings have been preparing for the proposed changes to the legislation since it was announced, making provision for the additional complexity it is bound to introduce.

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Every set of changes is a layer on top of an already complex system, and fund managers need to know that the increased complexity will not result in increased costs and risks. In fact, MIP will have all the changes tested, implemented and ready for the March 2024 deadline to ensure South African funds are able to service their clients and meet the needs of the new legislation.

This is in sharp contrast to international systems providers, who have admitted meeting the deadline will be challenging.

Local systems providers offer a number of advantages, not least of which is the agility needed to deal with shifting goal posts. The unsettled legislative landscape is far less challenging for South African companies – which have an intimate understanding of the needs and goals of all stakeholders – than it is for international organisations that rely on much longer, and far more delineated, release cycles.

In addition, companies like MIP have years of experience fulfilling the specific needs of local financial services organisations, and they have far more experience navigating the specialised conditions they operate under.

In an industry where every transaction equates to a life-changing decision, financial services organisations have had to learn how to connect legislative needs with those of beneficiaries. The new two-pot retirement system is a new step in this journey, and local providers are not only up to the challenge, they are relishing it.

ABOUT THE AUTHOR

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