

EARLY ACCESS TO PENSION SAVINGS – THE IMPACT ON THE RETIREMENT FUND SYSTEM

The new two-pot system will provide short relief for SA retirement fund members, but the trade-off will include increased complexity and possibly increased administrative costs, notes Blessing Utete, Managing Executive: Old Mutual Corporate Consultants.

South Africans have welcomed the government's proposal for a two-pot pension system. Unsurprisingly, the interest among retirement fund members centres around early accessibility instead of the bigger picture – improving retirement savings to avoid poverty after retirement.

In the new system, one-third of members' contributions will be invested in the accessible pot and two-thirds in the inaccessible retirement pot. For the inaccessible pot, it will essentially be business as usual.

The need to access retirement savings was starkly contrasted by the Covid-19-induced economic downturn and recently exacerbated by some of the highest cost of living increases in years. This current financial hardship must be weighed against the reality facing most South Africans in the long term.

This savings crisis is illustrated vividly in a recent social experiment conducted by Old Mutual. The exercise recorded eight South African families from a cross-section of society who were asked to fill a shopping trolley with all the groceries they needed in a month. They didn't realise until checkout that food prices were adjusted to what they would be when the breadwinner retires.

The findings were a rude awakening to participants and employers that South Africans are under-prepared for retirement. In the experiment, for example, certain families were over budget between 100% and 800%.

The pressing issue facing retirement fund members now is the impact of this policy on the inaccessible pot and the performance of the remaining assets. Whilst the structure of an inaccessible pot has been widely supported as over time it means better

retirement outcomes for members. To assess the implications of the envisaged two pot system, there are several issues to consider some of which include – the impact on overall fund liquidity, additional administration involved, and tax implications.

Under the current regime, funds are already paying out of investment portfolios because of the usual withdrawal claims, which are paid out fairly regularly in the case of resignations, deaths, disability and retirements. Fortunately, most funds are generally reasonably accessible from a liquidity perspective, which is unlikely to change in the new accessible pot system.

These funds are structured in such a way to accommodate pay-outs in a market that is also fairly liquid. For example, during major retrenchments or when a company is closing down, asset managers may need some notice to disinvest, but that is normally done fairly quickly. Those large volumes of claims are processed swiftly.

Alternatively, the cash flows that are coming into the funds are also utilised to manage some of the ongoing claims needs.

Withdrawals are managed closely with the fund administrator if there is a large volume.

There is constant communication between the fund administrator and the asset manager on significant flows that are going to be coming through. Funds may also have their own cash flow management policy that they instruct the asset manager to utilise. The discretion will lie with the asset manager as to how they will best manage the liquidity needs of the portfolio given the requirements for the accessible pot.

Retirement Funds will more than likely have to consider the need for different investment strategies better suited to the two pots. In the accessible pot there may be really liquid and less volatile investments that are short term, in order to limit the impact of market movements. Whereas in the non-accessible pot there will be more investment in growth products with a more targeted investment strategy geared for the long term.

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Greater complexity leads to an increase in costs

The two-pot system now means that retirement funds must have some transactional component, as members can apply to the fund to access their money at regular intervals. While the systems are already in place to cater for withdrawals, retirements and resignations, the need may arise for administrative changes to address an increase of withdrawals and the frequency thereof from the accessible pot.

In the occupational retirement funds, everything administratively is handled through the employer and their payroll. On resignation for example, the administrator, on receipt of the necessary claim forms from the employer processes the claim and applies for a tax directive in order to be able to settle the tax due and pay out the claim. It is envisaged that the new regime with two pots could result in members having to engage directly with funds for access to the accessible pot. Depending on the tax regime agreed, the administrator may still have to initiate the applications for a tax directive prior to payment. Where this currently happens only on resignation or retirement or death, in the future this could become an annual process as members apply for funds from the accessible pot.

In addition, enhanced recordkeeping will be needed, which inherently presents a different set of administrative challenges. This will result in more complexity, so it can be assumed that administrators would want to increase their administration costs on these frequent withdrawals. In addition, the transactional and administrative expense of selling investments, increasing liquidity and accessibility could also drive up fees. This increase will have to be passed on to the member, which will impact the amount of money invested, despite an increased focus on technology and automation.

Extent of tax regime changes uncertain

Under the current tax regime, members are exempt from tax on contributions made while saving for retirement (up to certain limits). They are exempt from gains on the investments while saving but are subject to income tax upon retirement as they draw down on their savings.

In the two-pot system, access to money for unforeseen circumstances will be impacted by the tax regime to which the withdrawal will be subject. Many questions remain to be answered.

How is the money going to be taxed when people access it? Will the current tax regime, remain or are we going to get a new regime?

The Association for Savings and Investment South Africa (Asisa) says the tax regime for retirement savings should not be changed when the two-pot system is introduced. Nonetheless, any changes should only be carefully considered later if the South African Revenue Service finds that certain members in higher tax brackets are using it to derive an unfair tax advantage.

Leaving the tax regime as is means that fund members will qualify for a tax deduction on contributions of up to 27.5% (capped at R350 000) a year of the greater of their taxable income or remuneration. It also means that pre-retirement withdrawals from the accessible pot or from vested savings will be subject to the punitive tax rates.

The tax treatment of withdrawals from the accessible pot could influence how much money and the frequency of access people apply for. Although we know that many people will still access funds, some may opt-out because of the tax implications.

In conclusion, while the move to the two-pot system is unlikely to impact the long-term performance of assets, the additional complexity will increase costs which will need to be considered by employers and stakeholders.

While this may appear to be a risk on the surface, this trend will likely result in greater consolidation of funds in South Africa. Umbrella funds, for example, are more efficient because of their reduced complexity and economies of scale.

Thanks to their size, automation costs, for example, could be spread over a larger pool of contributors, hopefully making retirement both accessible and affordable in the long term.



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