Report of the Standing Committee on Finance on the Revenue Laws Amendment Bill [B39 - 2023] (National Assembly- section 77), dated 4 December 2023

The Standing Committee on Finance, having considered the 2023 Revenue Laws Amendment Bill [B39 - 2023] (National Assembly- section 77) referred to it and classified as a Money Bill, reports the Bill with amendments [B39B – 2023]:

1. INTRODUCTION AND BACKGROUND

1.1. The Revenue Laws Amendment Bill (RLAB) was tabled in Parliament by the Minister of Finance on 01 November 2023, together with the 2023 Medium-Term Budget Policy Statement (2023 MTBPS). The RLAB is a section 77 (of the Constitution) Bill.

1.2. The tabling of this Bill was preceded by the publication of its draft version (Draft RLAB) on 9 June 2023, to solicit public comments.

1.3. The "Two-Pot" retirement system reform's primary objective is to provide flexibility for fund members to access their retirement savings during emergencies, without necessitating resignation. Traditional retirement systems primarily focus on long-term savings, often lacking the adaptability to address immediate financial crises.

1.4. This reform strives to strike a balance between long-term security and immediate needs, recognizing life's unpredictability. It permits fund members to access a portion of their savings during crises, such as those seen during the COVID-19 challenges. This change ensures the retirement system remains responsive to diverse financial needs, supporting both long-term financial security and immediate assistance during emergencies.

1.5. The Bill consists of eight clauses which introduce the “Two-Pot” retirement system.

2. PUBLIC PARTICIPATION

2.1. The Committee was briefed by National Treasury (NT) on the Draft RLAB on 29 August 2023 and held public hearings on 06 to 08 September 2023.

2.2. On 25 October, NT presented its detailed draft responses to the submissions made by Stakeholders to the Committee, addressing all the comments made during the public hearings, Committee briefings and deliberations.

2.3. The Committee received written and oral submissions from the following organisations: Old Mutual, South African Institute of Chartered Accountants (SAICA), South African Institute of Tax Practitioners (SAIT) PricewaterhouseCoopers (PwC), Congress of South African Trade Unions (COSATU), ASISA, IRFA and GEPF.

2.4. Overall, NT reported that 287 submissions were received on the “Two-Pot” Retirement System**.**

3. OVERVIEW OF THE KEY TAX PROPOSALS IN THE RLAB

3.1. The 2023 Revenue Laws Amendment Bill outlines changes to the retirement fund system in South Africa, specifically addressing the introduction of a "Two Pot" retirement system.

Introduction and Background

3.2. South Africa has historically offered a range of retirement fund options, including pension funds, provident funds, retirement annuity funds, pension preservation funds, and provident preservation funds. These funds featured distinct tax treatments for contributions and varying rules for withdrawals, leading to inconsistencies and complexities in retirement planning and fund access.

3.3. These differences in tax treatment and rules among retirement funds resulted in disparities, posing challenges for individuals as they navigated their retirement savings journey.

3.4. Initiated in 2012, the South African retirement fund system underwent significant reforms to address these issues and create a more streamlined and equitable framework. The objectives of these reforms were:

- Harmonizing Tax Treatment: Ensuring consistent tax treatment for contributions across different fund types.
- Increasing Preservation: Encouraging individuals to preserve their retirement savings both before and after retirement to enhance financial security in later years.
- Lowering Charges: Reducing fees associated with retirement funds to increase the value of savings.
- Improving Defaults, Governance, and Market Conduct: Enhancing the management of funds, their default investment options, governance standards, and overall market conduct.

3.5. Certain reforms have already been implemented, such as standardizing the tax treatment of contributions across fund types, which commenced on March 1, 2016.

3.6. The proposed "two-pots" retirement system seeks to further address these concerns, while also adhering to the principles of exempting contributions and their growth and taxing benefits upon withdrawal.

Rationale and Objectives of the Two Pot Retirement System

3.7. One key concern is the lack of motivation for individuals to preserve their retirement savings before retirement. Current retirement funds often only provide access upon leaving employment, which may not align with individuals' financial needs and goals.

3.8. Another concern is the absence of an option for households facing financial distress to access their retirement funds in emergencies under the current structure.

3.9. To tackle these issues, the government proposes the implementation of the "two-pot" retirement system.

3.10. Under this system, contributions and their growth within retirement funds remain tax-exempt. Individuals will not be taxed on their contributions or the growth of those contributions.

3.11. However, when benefits are withdrawn, either upon retirement or withdrawal in cases of emergency, they become subject to taxation. This approach aligns with the Exempt-Exempt-Taxed (EET) principle, ensuring contributions and growth are exempt from taxation, but withdrawals are taxed.

3.12. The reform aims to encourage preservation before retirement and provide access to funds in emergencies.

3.13. The EET system ensures that income is taxed only once, promoting consistency in tax treatment.

3.14. The proposed system simplifies the valuation of growth on contributions and provides a clear taxation framework upon withdrawal.

3.15. Under both the current and proposed systems, retirement fund members are allowed a deduction for contributions to their funds, limited to the lesser of R350,000 or 27.5% of taxable income or remuneration, encouraging retirement savings with tax benefits.

3.16. The reform permits Section 37D deductions under the Pension Funds Act, 1956, against both the "vested component" and the "retirement component" of the funds, incentivizing savings through additional deductions.

3.17. Contributions made by employers on behalf of employees are treated as taxable fringe benefits in the employee's hands, ensuring equitable tax treatment for both employee and employer contributions.

3.18. Contributions and growth related to the pre-implementation period follow existing rules, while contributions related to a post-implementation period are allocated to the "savings component" and "retirement component" as part of the "two-pot" framework.

Introducing Seed Capital

3.19. The introduction of seed capital in the proposed "two-pot" retirement system addresses the need for immediate fund access and provides an initial balance to members.

3.20. Seed capital allows retirement fund members to access a portion of their savings upon the system's implementation, offering them a starting balance.

3.21. It constitutes the initial balance in the "savings component" of the fund, providing members with an immediate withdrawal option.

3.22. Seed capital is derived from reallocating funds from the "vested component" to the "savings component."

3.23. A formula limits the seed capital to the lesser of 10% of the "vested component" or R30,000, ensuring a reasonable portion for initial access.

3.24. This concept strikes a balance between offering pre-retirement access and preserving retirement benefits.

3.25. The introduction of seed capital caters to immediate needs while promoting long-term financial planning within the "two-pot" retirement system. It seeks to provide individuals with flexibility and responsible financial choices.

Introducing the "Savings Component"

3.26. The introduction of the "savings component" is a response to the need for individuals to have flexible access to their retirement funds for various reasons, even before reaching the official retirement age. This provision aims to provide financial security and flexibility, enabling members to make withdrawals without the requirement of ending their employment. The system is structured to balance responsible financial behavior with individual needs.

3.27. Under the proposed framework, retirement funds will establish a new segment called the "savings component." This component is intended to offer members the capability to access a portion of their retirement savings before reaching retirement age.

3.28. Individuals will contribute one-third of their total retirement fund contributions to the "savings component", that portion of their contributions will be allocated to this component.

3.29. The assets within the "savings component" can be withdrawn before reaching the official retirement age, addressing the need for individuals to have access to their funds for various financial goals or unforeseen emergencies.

3.30. Different from traditional retirement withdrawals, which often necessitate leaving employment or retiring, the "savings component" offers flexibility. It allows individuals to access their savings without requiring significant life changes.

3.31. Members can make a single withdrawal from the "savings component" within a specific year of assessment, providing them with the freedom to choose when to access these funds based on their financial circumstances.

3.32. The proposed minimum withdrawal amount is set at R2,000, establishing a threshold for the smallest withdrawal possible from the "savings component."

3.33. In cases where a member resigns from employment and has already made their single withdrawal for that tax year, an additional withdrawal may be permitted if the member's gross interest in the "savings component" is less than R2,000. This condition outlines the circumstances for accessing additional funds.

3.34. The ability to withdraw from the "savings component" applies on a per-fund or per-contract basis. This means members can access their savings independently from each fund or contract they are associated with.

3.35. Withdrawals from the "savings component" are treated as taxable income for individuals. These withdrawals are added to the individual's taxable income and taxed based on their marginal tax rates, aligning with the general principle that retirement fund withdrawals are treated as income and subject to appropriate taxation.

3.36. In case of a member's passing, beneficiaries have two options for receiving the benefit from the "savings component":

- Lump Sum: Beneficiaries can opt for a lump sum payment of the benefit.
- Transfer to Retirement Component: Alternatively, beneficiaries may choose to transfer the benefit to the "retirement component" of their retirement fund. From there, they can receive the benefit as annuity payments over a specified period.

Introduction of the "Retirement Component"

3.37. The "retirement component" is designed to ensure that a substantial portion of retirement savings is preserved until retirement, providing a secure income stream in the form of annuities during the retiree's later years. The inclusion of the de-minimis limit recognizes that it may be more financially viable for some individuals to receive a lump sum under certain circumstances. This component adds depth to the proposed retirement system by addressing both the preservation and payout aspects of retirement funds.

3.38. The provisions for withdrawals from the "retirement component" in the proposed retirement regime include the ability to access funds as a lump sum under specific circumstances.

3.39. Retirement funds will be required to create a separate segment within the existing fund structure, known as the "retirement component." This component is designed to hold a significant portion of individuals' retirement savings, focusing on long-term preservation and providing annuities upon retirement.

3.40. Individuals will contribute two-thirds of their total retirement fund contributions to the "retirement component." This means that a substantial portion of the contributions made to their retirement fund will be allocated to the "retirement component."

3.41. The assets within the "retirement component" are required to be preserved until the individual reaches retirement age. Withdrawals from this component are only permitted upon retirement, following the fund's rules.

3.42. When a member reaches retirement age and decides to retire, the "retirement component" is to be paid out in the form of an annuity. Annuities provide regular payments to retirees, offering a steady stream of income during retirement years.

3.43. The current de-minimis limit applicable to the commutation of annuities is R165,000. This means that balances in the “retirement component” below this limit can be commuted (converted) to a lump sum.

3.44. The ability to commute (convert) an annuity into a lump sum will be determined based on the member's interests in both the "vested component" and the "retirement component." This determination is made on a per-fund basis.

3.45. The "retirement component" of the retirement fund holds a significant portion of an individual's retirement savings, with the intention of providing a steady income stream in the form of annuities during retirement.

3.46. Withdrawals from the "retirement component" become accessible as a lump sum when an individual ceases to be a tax resident of South Africa. This means that if an individual is no longer considered a tax resident of South Africa, they have the option to withdraw the funds as a lump sum.

3.47. The option of accessing a lump sum upon ceasing to be a tax resident is subject to the "3-year rule". This rule mirrors the existing requirement under the current regime for members of retirement annuity funds, pension preservation funds, or provident preservation funds. Under the current retirement rules, members of those funds are allowed to access their retirement savings as a lump sum after a three-year waiting period from the date of their non-tax resident status.

3.48. The same "3-year rule" is proposed to apply to withdrawals from the "retirement component" as a lump sum for non-resident taxpayers. The inclusion of the "3-year rule" ensures that the withdrawal of retirement savings as a lump sum for non-resident taxpayers is subject to a waiting period. This measure is likely in place to prevent individuals from taking advantage of non-residency solely for the purpose of accessing their retirement savings as a lump sum. It aligns with the broader goal of promoting responsible use of retirement funds while acknowledging individuals' changing circumstances.

Introduction of the "Vested Component"

3.49. The creation of the "vested component" serves to provide clarity and organization within the retirement fund structure. By valuing the member's retirement interest as of a specific date and retaining the rights that have vested due to previous reforms, the "vested component" ensures that both existing and new tax rules are properly managed within the framework of the proposed retirement system. The rules regarding contributions to the "vested component" aim to create a balanced approach that considers the age and type of fund of each member.

3.50. The option for older provident fund members to opt into the two-pot system acknowledges their unique situation while maintaining consistency with the overall structure of the proposed retirement system. The integration of existing rules into the "vested component" ensures consistency and coherence within the retirement fund structure. It maintains the application of established practices while providing opportunities for individuals to access their funds under specific circumstances, such as emigration. The "3-year rule" reinforces responsible management of retirement funds and aligns with broader objectives of preserving these funds for long-term financial security.

3.51. Retirement funds will be required to create a separate segment known as the "vested component." This component serves to distinguish between vested and non-vested rights arising as a result of the annuitisation provisions in relation to a member's retirement interest (known as T-Day rights).

3.52. To determine the member's rights within the "vested component," retirement funds will be required to value the member's retirement interest as of the day just before the implementation date, which is March 1, 2025. This valuation will encompass the rights that have vested and those that have not.

3.53. The rights that have vested and non-vested rights that arose due to the annuitisation reform, effective from March 1, 2021, will be retained within the "vested component." This implies that the changes brought about by the annuitisation reform will continue to apply in the context of the "vested component."

3.54. Under the new regime, once it comes into effect, members will generally not be allowed to make contributions to their "vested component." This component holds T-Day vested and non-vested rights in relation to a member's retirement interest.

3.55. Members of a provident fund who were 55 years or older on March 1, 2021, are exempt from this restriction. These members are allowed to continue making contributions to their "vested component."

3.56. Provident fund members who meet the age criteria can continue contributing to their "vested component" until they either retire from or leave the fund they were a member of on March 1, 2021. Their full contributions will be allocated to the "vested component."

3.57. Members who continue contributing to their "vested component" will not be able to contribute to the "savings component" or "retirement component."

3.58. Members aged 55+ from provident funds can choose to participate in the "two-pot" regime. If they elect to do so, they will no longer be able to contribute to their "vested component." Instead, their contributions will be split between the "savings component" and "retirement component," aligning with the contribution structure of other retirement fund members.

3.59. The amounts held within the "vested component" will be governed by the current retirement regime. This includes various existing rules and practices related to retirement funds.

3.60. Specific Inclusions from the Current Regime: Within the "vested component," the current retirement regime's provisions will apply, which involve:

- The ability to make once-off withdrawals from preservation funds.
- Access to pension and provident funds upon resignation.
- Continued protection of vested rights resulting from the annuitisation reform.
- Mandatory annuitisation of two-thirds of a member's retirement interest, effective from March 1, 2021.

3.61. Withdrawals from the "vested component" are accessible as a lump sum when an individual ceases to be a tax resident of South Africa. This provides an avenue for individuals who have left the country to access their retirement funds.

3.62. Like the existing requirement, the ability to access the lump sum upon change in tax residency is subject to the "3-year rule". Members are required to wait for a specified period (three years) from the date of change in tax residence before they can withdraw their funds as a lump sum.

Inclusion of Defined Benefit Funds

3.63. The proposal to include defined benefit funds in the "two-pot" retirement regime involves adapting the contribution calculations to align with the unique structure of these funds. Incorporating defined benefit funds into the "two-pot" retirement regime demonstrates flexibility in recognizing the diversity of retirement fund structures. By adjusting the contribution calculations to fit the defined formula used in these funds, the proposal aims to ensure equitable treatment while adhering to the overarching principles of the new retirement system.

3.64. The proposed "two-pot" retirement regime aims to accommodate defined benefit funds, recognizing their distinct contribution structure based on a defined formula rather than contributions and investment performance.

3.65. Given that defined benefit funds operate differently, the contribution calculations for these funds within the "two-pot" regime will be adjusted accordingly. Specifically:

3.65.1. Savings Component: Contributions to the "savings component" will be calculated based on one-third of the member's pensionable service.

3.65.2. Retirement Component: Contributions to the "retirement component" will be calculated based on two-thirds of the member's pensionable service.

3.66. The adjusted contribution calculations for defined benefit funds will come into effect from March 1, 2025, aligning with the implementation of the "two-pot" regime.

3.67. The calculation of seed capital for defined benefit funds will follow the same method as applied to other funds. Any necessary adjustments, particularly related to past service, can be made to accommodate the calculation of seed capital within the context of defined benefit funds.

Exclusion of Legacy Retirement Annuity Funds

3.68. The exemption for legacy retirement annuity funds acknowledges the intricacies associated with integrating historical policies into a new retirement system. By specifying the features and effective date for the exemption, and by involving the Financial Sector Conduct Authority (FSCA) in the verification process, the proposal seeks to provide clarity and a structured approach to managing these legacy policies within the context of the evolving retirement landscape.

3.69. The proposal regarding legacy retirement annuity funds reflects a recognition of the complexities associated with integrating historically acquired policies into the new "two-pot" retirement system.

3.70. The proposal suggests that legacy retirement annuity funds be excluded from the provisions of the "two-pot" retirement system. This decision is based on the understanding that including these legacy funds in the new system would necessitate a redesign of these historically acquired policies.

3.71. The exemption is not a blanket rule and applies only to legacy funds with certain features. These features include:

- Pre-universal life policies or conventional policies with or without profits.
- Universal life policies with life or lump-sum disability cover.
- Reversionary bonus or universal life policies as defined or referenced in insurance legislation.

3.72. The exemption for legacy policies applies to those entered into before 1 March 2025. This ensures that only legacy policies existing prior to the formulation of the "two-pot" regime are covered by this exemption.

3.73. For a legacy fund to be exempted, it must submit a signed declaration to the FSCA affirming that it meets the specified criteria. The FSCA may conduct verifications to ensure that the funds indeed satisfy the exemption criteria.

Fund Transfers

3.74. The proposed rules regarding intra-fund and inter-fund transfers within the "two-pot" retirement regime aim to provide members with flexibility while maintaining certain restrictions. These transfer provisions are designed to offer members the ability to manage their retirement savings within the framework of the "two-pot" retirement regime.

3.75. Intra-fund transfers provide flexibility for reallocating funds between different components of the same fund, while inter-fund transfers are limited to specific life events (resignation, retirement or termination of membership of a specific fund) and involve a complete transfer of all components. These rules aim to balance individual choice with the preservation of the overall integrity and intent of the retirement system.

3.76. The inter-fund transfer provisions offer members the ability to move their retirement savings between different funds, preserving tax benefits and maintaining the integrity of the proposed retirement system. The requirement for a tax directive adds a layer of oversight and ensures that the transfers are compliant with tax rules.

3.77. Intra-Fund Transfers: Members are allowed to make intra-fund transfers at any time they wish, and these transfers are treated as tax-free transfers. Specifically:

- From "Savings Component" to "Retirement Component": Members can transfer funds from their "savings component" to their "retirement component."
- From "Vested Component" to "Retirement Component": Members can also transfer funds from their "vested component" to their "retirement component."

3.78. Inter-Fund Transfers: Inter-fund transfers involve moving funds between different funds and are subject to specific conditions:

- Permissible on Resignation, Retirement or termination of membership: Inter-fund transfers are allowed only when a member resigns, retires or terminates their membership from their respective fund.

3.79. Full Transfer of Components: If a member chooses to make an inter-fund transfer, all components (savings, vested, and retirement) need to be transferred to the receiving fund. This means that members cannot selectively transfer only one component while leaving the others behind.

3.80. Tax-Free Transfers: Inter-fund transfers will be allowed as tax-free transfers when the entire relevant component is being transferred. Specifically:

- From "Savings Component" to "Savings Component": Members can transfer funds from the "savings component" of the transferor fund to the "savings component" of the transferee fund.
- From "Savings Component" to "Retirement Component": Members can also transfer funds from the "savings component" of the transferor fund to the "retirement component" of the transferee fund.
- From "Vested Component" to "Vested Component": Transfers can occur between the "vested component" of the transferor fund and the "vested component" of the transferee fund.
- From "Vested Component" to "Retirement Component": Members can also transfer funds from the "vested component" of the transferor fund to the "retirement component" of the transferee fund.
- From "Retirement Component" to "Retirement Component": Transfers can occur between the "retirement component" of the transferor fund and the "retirement component" of the transferee fund.

3.81. Both inter-fund and intra-fund transfers will require the fund to obtain a tax directive. A tax directive is a formal request made by the fund to obtain tax instructions from the tax authorities, ensuring that the transfers are conducted in accordance with tax rules.

4. KEY ISSUES RAISED IN THE PUBLIC HEARINGS

4.1. During the public hearings and deliberations on the 2023 draft RLAB, a prominent focal point was the introduction of the "two-pot" retirement system, which aims to revolutionize the retirement fund landscape.

4.2. The proposed implementation date was originally set for March 1, 2024. This reform would enable retirement fund members to access a portion of their accumulated benefits in the "vested component" at the time of implementation.

4.3. Stakeholders mostly supported the reforms, although a minority expressed objections. Some of these dissenting voices preferred to maintain contributions in a consolidated retirement component, as they believed it would yield better investment gains over more extended periods. This diversity in opinions contributed to a nuanced conversation on the direction of the reform.

Proposed Implementation Date

4.4. One of the significant areas of contention was the proposed implementation date. Some stakeholders argued that the timeframe was insufficient to accommodate the necessary preparations. They contended that a transition period of 12-18 months after the promulgation of legislation would be crucial for undertaking essential changes, such as updating systems, staff training, communication, and educating fund members about the intricacies of the "two-pot" system.

4.5. On the other hand, there were those who urged for the original effective date of March 1, 2024, citing the pressing financial needs of individuals that had been deferred due to the delay in implementing the legislation.

4.6. In response to these concerns, the NT accepted some comments while partially accepting others. Acknowledging the magnitude of the reform and the need for a seamless transition, NT extended the implementation date to March 1, 2025. This additional time, NT explained, would allow funds and trustees to consult with fund members about impending rule changes and clearly communicate the impacts of the reform on their future contributions.

Seed Capital Cap

4.7. The proposed cap for seeding capital was met with mixed reviews. Several commentators deemed it too low and suggested that the seeding amount should be increased. These requests spanned a wide range, from R50,000 to R500,000. Some even advocated for calculating the seeding capital as one-third of the “vested component” without applying the 10% limit.

4.8. Concerns were also raised regarding potential liquidity risks and adverse impacts on asset markets resulting from the seeding capital proposal.

4.9. In response, NT partially accepted these comments and is contemplating an inflation-adjusted cap of R30,000, considering the concerns raised. The fundamental premise was that the higher the seeding amount, the more detrimental the impact on retirement outcomes for fund members. Additionally, the potential risks associated with liquidity and asset markets were noted and will be taken into consideration.

Staggering Mechanism

4.10. Some stakeholders proposed the introduction of a staggering mechanism, such as withdrawals aligned with a member's birth month, to address liquidity concerns and market pressures. However, this recommendation was not accepted.

4.11. NT was concerned that staggering might introduce administrative complexities and not necessarily align with the varying needs and emergency circumstances of fund members.

Flexibility for Defined Benefit Funds

4.12. Another key issue was flexibility in the application of the “two-pot” system, particularly for defined benefit funds. It was suggested that some flexibility should be allowed for funds that cannot fully implement the system based on the reduction of pensionable service methodology.

4.13. The government accepted this suggestion and proposed that defined benefit funds not able to apply the reduction of pensionable service basis be allowed to use an alternative method for calculating the contribution split, subject to approval by the FSCA.

Deductions of Costs

4.14. There was also a debate around the deduction of costs from contributions versus costs from fund values. Commentators pointed out that while the Bill seemed explicit about deducting costs from contributions, funds were deducting costs from both contributions and fund values.

4.15. In response, NT accepted this input, indicating that the legislation would include enabling provisions for fee or cost deductions, with the nature and structure left to fund rules.

Legacy Retirement Annuity Policies

4.16. The definition of legacy retirement annuity policies was another point of contention. Stakeholders sought refinement to clarify which types of policies, such as universal life policies without risk cover, would be included, and how legacy retirement funds could be distinguished from other types of funds. Furthermore, they called for clarification regarding the exemption of contracts entered after January 1, 2022.

4.17. In response, NT accepted these comments and planned amendments to include features unique to legacy policies, adjust the exemption to apply only to contracts entered before the implementation date of the reform, and provide clarity on the content and format of the declaration required for legacy retirement annuity funds applying for an exemption from the "two-pot" system.

Regulation 28 and Compliance

4.18. Questions were raised about the applicability of Regulation 28 to investment strategies under the proposed regime and the "two-pot" system's compliance with Regulation 28 of the Pension Funds Act. The government did not accept this suggestion, as it deemed that the current Regulation 28 thresholds were sufficient for accommodating the "two-pot" system, eliminating the need for amendments.

Grandfathering Provisions

4.19. A request was made for clarity on the continuity of grandfathering provisions in Regulation 28 for retirement annuity funds following the "two-pot" system's implementation. The government noted this and proposed that retirement annuity funds retain their grandfathering status in terms of Regulation 28(3)(c) of the Pension Funds Act.

Provident Fund Members Over 55

4.20. There were discussions on the approach to be taken for provident fund members who were 55 years old and older on March 1, 2021. It was suggested that the default position for this group should be exclusion from the "two-pot" system, with an opt-in option.

4.21. NT noted this input and decided to amend the draft legislation to reflect this policy position, allowing provident fund members in this age category to be excluded by default but providing them with the choice to opt in.

Exemption Extension

4.22. Finally, there was a general consensus that the exemption from the "two-pot" regime should not be limited to legacy retirement annuity funds only. There was a call for the exemption to extend to funds with no active participating members, such as those in liquidation, beneficiary funds, closed funds, dormant funds, and pensioners.

4.23. NT accepted this proposal, suggesting that these funds and pensioners be exempted from the "two-pot" regime.

Allowable Withdrawals and Tax Treatment upon Cessation of Tax Residence

4.24. During the discussions, stakeholders raised concerns about how allowable withdrawals and tax treatment would be handled when members cease tax residence in South Africa.

4.25. NT clarified that the current treatment of withdrawals would continue to apply, with withdrawals taxed according to relevant lump sum tax tables. Preservation and occupational fund members would retain eligibility for withdrawals, as the "vested component" would follow existing provisions, including a 3-year waiting period.

4.26. The "savings component" would remain accessible upon exit and taxed at marginal tax rates when withdrawn, and the "retirement component" would become available for withdrawal after 3 years, subject to relevant withdrawal tax table.

Commutation Upon Retirement and *De Minimis* Value

4.27. Concerns arose regarding the commutation amount at retirement and its tax treatment, especially which components the *de minimis* value will apply to. In response, the government outlined three distinct options for members with remaining "savings component" amounts upon retirement, each having a specific tax treatment.

4.28. Option 1: Withdrawal upon retirement: If the "savings component" is withdrawn upon retirement, such withdrawal is taxed as a retirement lump sum.

4.29. Option 2: Transfer to the “retirement component”: All or a portion of the “savings component” upon retirement can be transferred to the “retirement component”. This entails receiving regular annuity payments, taxed as income in the respective tax year.

4.30. Option 3: Withdraw after retirement: Any withdrawals from the “savings component” after retiring will be subject to the tax treatment applicable to withdrawals prior to reaching retirement age.

4.31. The *de minimis* will not apply to balances in the “savings component”. As such it will only apply to the “retirement and vested components”. The *de minimis* value triggering automatic commutation is calculated based on a specific formula and threshold specified in accompanying tax regulations. Exact details and the threshold value will be provided in the regulations associated with the retirement system.

Annuitization Proportion

4.32. The issue of reducing the annuitization proportion of the “vested component” and “retirement component” surfaced during deliberations. Some stakeholders proposed this change to introduce more flexibility in accessing retirement funds. However, NT opted not to accept this suggestion, citing several reasons.

4.33. NT's primary concern is to ensure that individuals have a dependable source of income during their retirement years. The annuitization of a portion of retirement savings is a common practice to guarantee a steady income stream. By maintaining a fixed annuitization proportion for the “vested and retirement components”, NT aims to safeguard the financial security of retirees.

4.34. Allowing unrestricted access to these components without an annuitization requirement could pose a risk to individuals who might deplete their retirement savings prematurely. NT's decision to maintain the annuitization proportion is driven by a desire to protect retirees from running out of funds during their retirement years.

4.35. A fixed annuitization proportion contributes to the long-term sustainability of retirement funds. It helps to ensure that retirees receive regular income for the entirety of their retirement, reducing the potential burden on the government and social welfare programs.

4.36. Consistency in the treatment of retirement funds and annuitization practices across the components simplifies the system for both members and providers. It also aligns with the traditional approach to retirement planning.

Taxation of Withdrawals from the Savings Component

4.37. Stakeholders had differing views on the taxation of withdrawals from the savings component, with some proposing alternative methods such as flat rates or reverting to the pre-retirement withdrawal table. NT’s response indicated that this aspect had been considered in previous discussions and draft amendments, with the decision to harmonize tax rates for progressivity, equity, simplicity, and preservation.

Amendments to Paragraph 9 of the Fourth Schedule

4.38. In the RLAB, amendments to paragraph 9 of the Fourth Schedule were discussed. Stakeholders expressed concerns about implementing a directive system similar to pre-retirement withdrawals and suggested alternatives, mainly flat rates for withholding purposes. NT’s response partially accepted this feedback and indicated that the drafting would be corrected to refer to the withholding method contemplated in paragraph 2(2B) of the Fourth Schedule.

Section 37D Deductions

4.39. Comments and responses on the 2023 Draft Pension Fund Amendment Bill focused on various aspects of the legislation. Some comments requested that section 37D deductions in terms of the Pension Funds Act be calculated and settled proportionally across all three components, which was accepted.

Treatment of Section 37D Divorce Order-Related Transfers

4.40. Another comment sought clarity on the treatment of section 37D divorce order-related transfers to a non-member spouse's retirement fund, which would maintain the components from where benefits were transferred. The response indicated agreement with the comment as NT endeavoured to ensure the legislation provided the necessary clarity as relates to this policy position.

Definition of the Retirement Component and Death Benefits

4.41. A comment sought clarification on the definition of the “retirement component” and changes related to the payment of death benefits. The response noted that legislation would be amended to retain the current disposition of death benefits in line with section 37C of the Pension Funds Act.

Conclusion

4.42. The discussions surrounding the "two-pot" retirement system were marked by a diversity of opinions, leading to a series of accepted, partially accepted, and not accepted comments and suggestions from stakeholders. NT sought to balance the need for an effective transition with the concerns and preferences of fund members and providers, ultimately aiming to create a retirement system that offers flexibility and improves retirement outcomes. These deliberations and responses have shaped the direction of the RLAB and its provisions related to the "two-pot" retirement system.

5. AMENDMENTS TO THE RLAB

5.1. During the meeting on 21 November 2023, the Committee deliberated on the Revenue Laws Amendment Bill (RLAB) and made a decision to amend the implementation date of the "two-pot" system from 1 March 2025 to 1 March 2024. According to the Money Bills and Amendment of Revenue Laws Act, Section 11 outlines the process for passing revenue bills, including the crucial step of consulting the Minister of Finance before amending a Money Bill.

5.2. The Chairperson of the Committee, Mr Joseph Maswanganyi, formally notified the Minister of Finance of this proposed amendment, emphasizing that it does not have a negative impact on the fiscus. In compliance with section 11(5) of the Act, the Chairperson provided the Minister with a 14-working-day period to respond to the proposed amendment.

5.3. On 3 December, the Minister of Finance responded, expressing concerns about the suggested date of 1 March 2024. Instead, he recommended a new date of 1 September 2024. One of the primary concerns raised by the Minister was the non-tabling of the Pension Funds Amendment (PFA) Bill in Parliament, a critical element for the effective implementation of the Revenue Laws Amendment Bill. The PFA Bill facilitates the adjustment of retirement funds' rules to accommodate the proposed "two-pot" system.

5.4. The Minister outlined uncertainties regarding the legislative process and associated timelines, casting doubt on the completion of the process, including the tabling of the PFA Bill, by 1 March 2024. Additionally, he underscored the time required for funds to amend their rules and gain approval from the Financial Sector Conduct Authority (FSCA).

5.5. Concerns were also raised by the Minister about the withdrawal process and tax withholding. The correct tax rates for withdrawals under the new system depend on the promulgation of legislation, with the South African Revenue Service (SARS) indicating a need for at least six months after promulgation to implement the necessary systems.

5.6. The Minister discussed potential negative impacts on markets and fund managers if the proposed implementation date of 1 March 2024 is retained. Urgency in reallocating portfolios was emphasized, which could potentially cause adverse effects on the market.

5.7. Furthermore, the Minister highlighted the importance of a comprehensive communication and education campaign to inform retirement fund members about the implications of the new system.

5.8. In proposing a solution, the Minister suggested a delay in the implementation date to 1 September 2024. He indicated that discussions with stakeholders, including SARS, FSCA, GEPF, and the Government Pensions Administration Agency, indicated that a 1 September 2024 implementation date was achievable.

5.9. The Minister acknowledged potential frustrations arising from the delay but underscored the necessity of ensuring a smooth and well-prepared implementation of the retirement system restructuring.

6. COMMITTEE OBSERVATIONS AND RECOMMENDATIONS

6.1. The Committee's observations and recommendations are intended to ensure the successful implementation of the “Two-Pot” Retirement System and associated reforms, balancing the diverse perspectives of stakeholders while prioritizing the long-term financial well-being of fund members and retirees.

Introduction of the "Two-Pot" Retirement Regime

6.2. The Committee notes the comprehensive introduction of the "two-pot" retirement regime, which aims to transform the retirement landscape by emphasizing preservation and responsible management of retirement funds. This introduction offers a promising approach to address various challenges in the existing retirement system.

Implementation Date and Transition Period

6.3. The Committee has taken into account the concerns raised by stakeholders regarding the initially proposed implementation date of 1 March 2025 for the "Two-Pot" Retirement System. Consequently, an amendment was proposed by the Committee to shift the implementation date from 1 March 2025 to 1 March 2024, as detailed in the preceding sections of this report. Following consultations with the Minister of Finance, the Committee is of the opinion that the revised date of 1 September 2024 is acceptable, considering the explanations provided by the Minister of Finance.

6.4. The Committee gives its approval to the new date of 1 September 2024 and endorses all consequential amendments in the Bill arising from this amendment.

Staggering Mechanism

6.5. Regarding the proposed staggering mechanism to address liquidity concerns and market pressures, the Committee deems it unnecessary given the agreement on the new implementation date of 1 September 2024. The Minister, in consultation with state agencies following the Committee's letter on 21 November 2024, has endorsed the revised date, alleviating the need for the previously considered staggering mechanism.

Seed Capital Cap

6.6. The Committee acknowledges the mixed reviews concerning the proposed seeding capital cap. While some stakeholders advocated for a higher cap, others expressed concerns about potential liquidity risks. The Committee recommends that NT proceeds with the contemplated inflation-adjusted cap of R30,000 while monitoring its effects on liquidity and asset markets.

Flexibility for Defined Benefit Funds

6.7. The Committee endorses NT's proposal to allow defined benefit funds unable to fully implement the “Two-Pot” system based on the reduction of pensionable service methodology to use an alternative method for calculating the contribution split, subject to approval by FSCA.

Deductions of Costs

6.8. The Committee supports NT's decision to include enabling provisions for fee or cost deductions in the legislation, with the specific nature and structure left to fund rules. This flexibility aligns with the diverse needs of fund members and providers, allowing for customization while ensuring that fees and costs are managed in a transparent and fair manner within the fund's established guidelines.

Legacy Retirement Annuity Policies

6.9. The Committee welcomes NT's acceptance of comments to refine the definition of legacy retirement annuity policies. The proposed amendments, including features unique to legacy policies and clarifications regarding contract exemptions, are considered appropriate.

Regulation 28 and Compliance

6.10. The Committee is satisfied with NT's stance on the applicability of Regulation 28 to investment strategies under the “Two-Pot” system. NT's assertion that the current Regulation 28 thresholds are adequate is accepted.

Grandfathering Provisions

6.11. The Committee emphasizes the importance of ensuring continuity in grandfathering provisions for retirement annuity funds following the implementation of the “Two-Pot system”. The proposed retention of grandfathering status in terms of Regulation 28(3)(c) of the Pension Funds Act is endorsed.

Providence Fund Members Aged 55 and Older

6.12. The Committee appreciates NT's responsiveness to concerns related to provident fund members aged 55 and older on March 1, 2021. The decision to exclude this group by default but provide them with the option to opt in is deemed an appropriate balance between flexibility and retirement planning.

Exemption Extension

6.13. The Committee fully supports the consensus to extend the exemption from the “Two-Pot” regime beyond legacy retirement annuity funds. The call for the exemption to encompass funds with no active participating members, including those in liquidation, beneficiary funds, closed funds, dormant funds, and pensioners, is endorsed.

Section 37D Deductions

6.14. Regarding the interaction between 2023 RLAB and Pension Fund Amendment Bill, the Committee observes the importance of proportionally calculating and settling section 37D deductions across all three components. This measure promotes consistency and fairness within the system and is endorsed.

Definition of the “Retirement Component” and Death Benefits

6.15. The Committee recognizes the importance of maintaining consistency in the treatment of retirement funds and annuitization practices across the components. The decision to retain the current disposition of death benefits in line with section 37C of the Pension Funds Act is supported.

Introduction of the "Retirement Component"

6.16. The Committee recognizes the "retirement component" as a critical feature of the proposed retirement system. It acknowledges the need to ensure long-term financial security for retirees through the promotion of annuities. The *de minimis* limit allows for flexibility while preserving the retirement income stream.

Rules for Withdrawals from the "Savings Component"

6.17. The Committee understands the importance of enabling members to access their “savings component” for specific life events such as emigration, disability, or severe financial distress. This aligns with the goal of providing financial flexibility while ensuring responsible fund management.

Promoting Annuities and Long-Term Security

6.18. The Committee supports the proposition that two-thirds of contributions are allocated to the retirement component. This promotes the long-term financial security of members through annuities while offering some flexibility for lump-sum payments under defined circumstances.

Introduction of the "Vested Component"

6.19. The creation of the "vested component" is noted as a significant step to organize and clarify the retirement fund structure. Retaining rights that have vested due to previous reforms and specifying the exemption for older provident fund members offers a balanced approach to fund management.

Withdrawals from the "Vested Component"

6.20. The Committee acknowledges the importance of maintaining vested and non-vested rights within the "vested component." The "3-year rule" aligns with broader objectives of preserving retirement funds for long-term financial security.

Inclusion of Defined Benefit Funds

6.21. The proposed adjustments for including defined benefit funds in the "two-pot" retirement regime are seen as a flexible approach to accommodate diverse fund structures while ensuring equitable treatment.

Exclusion of Legacy Retirement Annuity Funds

6.22. The Committee recognizes the need to address complexities in integrating legacy policies. The exemption criteria and involvement of the FSCA provide a structured approach for managing these legacy policies.

Fund Transfers

6.23. The proposed rules for intra-fund and inter-fund transfers offer members flexibility to manage their retirement savings. The tax directives add an important layer of oversight to ensure tax compliance during transfers.

Public Awareness and Education

6.24. The Committee recommends a robust public awareness and education campaign to inform retirement fund members about the features and benefits of the proposed "two-pot" retirement regime. This will empower individuals to make informed decisions about their retirement savings.

Monitoring and Oversight

6.25. The Committee suggests that NT and the relevant regulatory agencies heighten their monitoring of the implementation of this new retirement system and ensure compliance with the proposed rules. This oversight will help maintain the integrity of the system.

Periodic Review

6.26. The Committee proposes that the new retirement system undergoes periodic reviews and adjustments as needed to adapt to changing economic conditions, demographics, and member needs. Regular assessments will ensure the system remains effective and relevant.

Assistance for Legacy Funds

6.27. The Committee suggests providing assistance or guidelines for legacy retirement annuity funds to help them meet the specified criteria for exemption. Clear communication on the exemption process and criteria can aid legacy funds in transitioning effectively.

Member Information on Transfers

6.28. The Committee recommends that members are provided with comprehensive information and guidance on intra-fund and inter-fund transfers. This information should include tax implications, benefits, and risks to ensure members make well-informed transfer decisions.

Communication with Retirement Fund Members

6.29. The Committee recommends that retirement funds should prioritize clear and transparent communication with their members regarding the changes and benefits of the new system. Members need to understand how these changes will impact their retirement planning.

Feedback Mechanism

6.30. The Committee recommends that NT and regulators should establish a feedback mechanism to allow members and stakeholders to provide input and report concerns related to the new retirement system. Continuous feedback can inform necessary improvements and adjustments.

Capacity Building for Fund Administrators

6.31. The Committee urges retirement fund administrators to have the knowledge and capacity to implement the new system effectively. Training and resources may be necessary to facilitate a smooth transition.

Research and Data Collection

6.32. The Committee encourages research on retirement savings behaviour and preferences to inform future adjustments to the retirement system. Data collection on the impact of the changes will be valuable for evidence-based decision-making.

7. CONCLUSION

7.1. In reviewing the feedback received, it is evident that there is substantial support for the proposed reform. While some stakeholders have raised specific concerns or objections regarding the implementation of certain aspects of the reform, they generally endorse the overarching direction of the reform. Out of the 287 submissions, only 13 have expressed their opposition to the reform. Their dissenting views are grounded in a preference for not splitting contributions into two pots but rather consolidating them into the retirement component to maximize investment gains over more extended periods.

7.2. In response to this feedback, it is essential to underscore that the system will incorporate default settings. Members will retain the flexibility to consolidate their “savings component” into their “retirement component” should they choose to do so. This option remains available to members and is not precluded by the reform.

7.3. Through our observations and recommendations, the Committee aims to ensure a successful transition, balanced regulation, and a system that aligns with the diverse needs of stakeholders. The Committee stands committed to continuous monitoring, oversight, and responsiveness, reflecting our dedication to a retirement system that serves both the present and the future.

7.4. The Committee expresses its gratitude to the Minister of Finance for reaching a compromise and proposing the implementation date of 1 September 2024.

7.5. The Committee reports the Bill with amendments [B39B – 2023].

Report to be considered.