

## 1. Two pot system regarding early access to retirement savings

The second draft of the two pot legislation has been published for public comment on 9 June 2023. The commentary period will expire on 15 July 2023.

In terms of the two pot system, which will come into effect on 1 March 2024, retirement fund members will have access to a portion of their retirement savings before termination of their fund membership.

In terms of the new system three new components will be created within a retirement fund, namely a vested component, a retirement component and a savings component.

The vested component will consist of all contributions up to 29 February 2024, and the current retirement fund regime will remain applicable to this component. One third of contributions post 1 March 2024 will go to the savings component, and two thirds to the retirement component. In the case of defined benefit funds, the one third and two thirds must be calculated with reference to the member's pensionable service.

Arrear contributions that became payable before 1 March 2024, will be allocated to the vested component, despite the fact that they are only paid after 1 March 2024.

An important change from the previous draft of the legislation is that 10 percent of the value of the vested component as at 29 February 2024, to a maximum of R25 000, will be allocated to the savings component. This is to enable members to have immediate access to a portion of their retirement savings when the two pot system comes into effect.

No further contributions can be made to the vested component, except that members of provident funds who were 55 years or older on 1 March 2021 will have the option to continue contributing to the vested component. Should they elect to continue contributing to their vested component, their full contributions will be allocated to the vested component, and they will not be able to contribute to the savings component and retirement component.

As currently, contributions and growth will be exempt from tax, while withdrawals and benefits will be taxed.

Withdrawals from the savings component will be included in the member's taxable income for that year, and will be taxed at his/her marginal rate. The withdrawal tax table will accordingly not apply to withdrawals from the savings component. The withdrawal tax table will however still apply to withdrawals from the vested component. The fund will have to apply for a tax directive before paying a withdrawal from the savings component.

Amounts contributed to the retirement component cannot be accessed before retirement. At retirement date, the total value in the retirement component must be paid in the form of an annuity, except if the member's interest in the retirement component, calculated together with two thirds of the member's retirement interest in the vested component, does not exceed R165 000.

Amounts contributed to the savings component can be accessed without any conditions, but only one withdrawal can be made during a tax year. The minimum withdrawal amount is R2 000, and a member must accordingly have an amount of at least R2 000 in the savings component before being allowed to make a withdrawal. If a member resigns from employment, and he/she has already made a withdrawal during the tax year, an additional withdrawal will only be allowed if the member's interest in the savings component is less than R2 000.



Full withdrawals from the retirement and vested components can take place when a member emigrates from South Africa and ceases to be a tax resident. This is however subject to the 3-year rule that under the current regime applies to members of a retirement annuity fund or preservation fund.

Any funds available in the savings component at retirement or death can either be withdrawn in full or transferred to the retirement component. Where the member opts to withdraw funds from the savings component as a lump sum on retirement, it will be taxable as a retirement lump sum benefit subject to the retirement lump sum table.

Members cannot transfer amounts out of the retirement component, but can only transfer to the retirement component in another fund.

No transfers can be made into the savings component, unless they are from the savings component in another fund.

If a member transfers to another fund, all components must be transferred to the transferee fund. It is in other words not possible to transfer only one component while leaving the other components behind. Put differently, it will not be possible to split components between funds.

Both transfers of components between funds, and transfers to another component in the same fund, will be subject to the fund obtaining a tax directive.

Subject to certain conditions, legacy retirement annuity funds will be excluded from the two pot system. The reason for this is that the inclusion of these policies would require a re-design of the policies.

## 2. Amendments to the Pension Funds Act

Proposed amendments to the Pension Funds Act (“the Act”) have been published for public comment on 9 June 2023. The commentary period will expire on 15 July 2023. The proposed amendments are mainly aimed at making provision for the two pot system, but also deal with certain other aspects. Some of the more important amendments are as follows:

- A definition of “pension interest” is inserted in the Act, which will apply instead of the definition of “pension interest” in the Divorce Act. In terms of this definition a member of an occupational fund will not cease to have a pension interest when his service is terminated, and it will accordingly be possible to also make a pension interest allocation in the case of a paid-up member and a pensioner.
- Section 37D of the Act will be amended to make it possible for a non-member spouse to also receive a portion of the member’s pension interest in the case of the dissolution of a marriage in terms of the tenets of a religion.
- Fund return on the non-member’s portion of the pension interest will no longer accrue from the date of the deduction of such portion from the member’s benefit, but from the date of divorce.
- The maximum housing loan that may be granted to a member will be limited to a maximum of 65 percent of the member’s benefit. This is to bring it in line with the recent amendments to regulation 28 of the Pension Funds Act, which limit housing loans granted by retirement funds to a maximum of 65 percent of the fund’s total assets.
- Section 37D of the Act, with regard to damage caused to the employer by reason of theft, dishonesty, fraud or misconduct by the member, will be amended to stipulate that a deduction can also be made from the member’s benefit in the case of a compensation order in terms of section 300 of the Criminal Procedure Act. This is to resolve the problem caused by decisions by the Financial Services Tribunal to the effect that a deduction can only be made in the case of a civil judgment, and not in the case of a compensation order as aforesaid.
- A fund will not without the employer’s consent be able to permit a member to take a savings withdrawal benefit where an employer housing loan or guarantee has been furnished, or where there is a judgment in favour of the employer that has not yet been satisfied, unless the fund is satisfied that the remaining fund value will be sufficient to satisfy the judgment. A savings withdrawal benefit as aforesaid is a withdrawal from the savings component that will be established in terms of the two pot system.



- A fund will only be able to withhold a member's benefit so as to give the employer the opportunity to obtain judgment against the member, and will only be able to refuse to allow a member to take a savings withdrawal benefit, if a court has granted an order authorising the withholding or refusal. Once the amendment in this regard has been effected, it will in other words only be possible to withhold a member's benefit if this has been authorised by an order of court.
- A retirement fund may not without the consent of the member's spouse grant a housing loan to a member, or allow a member to take a savings withdrawal benefit, if it is aware that there is a pending divorce action.
- A deduction from a member's benefit in respect of future maintenance must be made in monthly payments or annually in advance, where a fund is unable to make monthly payments.
- A retirement fund may not allow a member to take a savings withdrawal benefit where there is a maintenance order in place, unless the fund is satisfied that the remaining fund value will be sufficient to comply with the order.

### 3. Pension Funds Adjudicator does not have jurisdiction to enforce divorce orders

The Pension Funds Adjudicator ("the Adjudicator") has in the April 2023 issue of its Quarterly Digest confirmed that it does not have jurisdiction to enforce compliance with divorce orders. This is so because in terms of the definition of "complaint" in the Pension Funds Act the Adjudicator can only adjudicate complaints "*relating to the administration of a fund, the investment of its funds or the interpretation and application of its rules*", and the enforcement of a court order does not relate to the administration of a fund, the investment of its funds or the interpretation and application of its rules.

The Adjudicator has, in support of the above, referred to the recent decision of the Financial Services Tribunal in the matter of *Momentum Retirement Annuity Fund and another v Pension Funds Adjudicator and another*, in which the Tribunal, inter alia, said the following:

*"Court orders are enforced either by way of a warrant of execution or by way of contempt of court proceedings. In an endeavour to enforce a court order, an applicant cannot lodge a complaint with the PFA (Pension Funds Adjudicator)."*

*"The definition of "complainant" is provided for in section 1 of the Act and it states that a complaint must relate to one of three things: (a) The administration of a fund; (b) the investment of its funds; or (c) the interpretation and application of its rules. The term administration is not defined in the Act, however, section 13B(1) of the Act provides that administration relates to the receipt of contributions or the disposition of benefits. It does not relate to the enforcement of court orders."*

### 4. Application of the *in duplum* rule to arrear contributions

The *in duplum* rule applies to interest on outstanding debt, and entails that the interest cannot be more than the capital amount of the outstanding debt. The Pension Funds Adjudicator ("the Adjudicator") has in the April 2023 issue of its Quarterly Digest confirmed that the *in duplum* rule also applies to late payment interest on retirement fund contributions. The Adjudicator in this regard said the following:

*"It is important for the Adjudicator and funds to apply the in duplum rule as these entities have a duty to be fair and impartial, not only to members of the fund but to the employers that participate in funds as well. In light of the in duplum rule, it cannot be considered fair for an employer to pay interest that exceeds its principal debt. Employers are encouraged to lodge complaints against funds that ignore this common law rule."*



## 5. Applicability of section 37C of the Pension Funds Act to paid-up members

The Financial Sector Conduct Authority (FSCA) has on 25 March 2020 published FSCA Interpretation Ruling 1 of 2020 (RF) (“the Ruling”), which deals with the applicability of section 37C of the Pension Funds Act to paid-up members and deferred retirees. According to the Ruling section 37C applies to paid-up members, deferred retirees and unclaimed benefits, where no election to withdraw has been made by the member prior to his/her death.

The correctness of the opinion expressed by the FSCA in the Ruling is unfortunately not beyond doubt. There is namely a school of thought which for the following reasons is of the view that section 37C does not apply to paid-up members and deferred retirees. Section 37C applies to “*any benefit ... payable ... upon the death of a member*”. The benefit of a paid-up member or deferred retiree becomes payable when he/she withdraws from service or retires. When a paid-up member or deferred retiree dies, one is accordingly not dealing with a benefit that became payable upon the death of the member as contemplated in section 37C. The benefit had namely already become payable upon the member’s withdrawal from service or retirement, with the result that section 37C is not applicable.

It is stated in the Ruling that it is issued “*to provide clarity, consistency and certainty in the interpretation and application of section 37C*”. It is however doubtful whether the Ruling provides such certainty. The only effect of the Ruling is namely that the FSCA must in terms of section 142(3) of the Financial Sector Regulation Act interpret section 37C in accordance with the Ruling. The Ruling is not binding on third parties, and more specifically on the executor of a deceased member’s estate. If a fund pays the benefit in respect of a deceased paid-up member or deferred retiree in terms of section 37C, and the executor of the member’s estate subsequently claims that the benefit should have been paid to the estate, it would therefore be no defence to say that the fund acted in terms of an FSCA interpretation ruling.

The Pension Funds Adjudicator (“the Adjudicator”) has in the April 2023 issue of its Quarterly Digest confirmed that it will follow the FSCA’s opinion as set out in the Ruling. The Adjudicator in this regard said the following:

*“Where a fund submits that a lumpsum benefit is not payable in terms of Section 37C, the Adjudicator will require proof in the form of a withdrawal claim form, that the member gave the fund a written instruction prior to his/her passing.”*

It is important to note that although we now know how the Adjudicator will deal with benefits that become payable upon the death of paid-up members and deferred retirees, this does still not resolve the legal uncertainty in this regard. It is namely not known whether the Financial Services Tribunal or a court of law will follow the same approach. The lack of certainty with regard to the applicability of section 37C of the Pension Funds Act to paid-up members and deferred retirees accordingly persists, and funds would be well-advised to deal with such cases with circumspection.

*Retirement funds or other clients requiring more information should not hesitate to contact their consultant.*