Investments

Understanding the two-pot retirement system:

a conversation with Avishal Seeth

In a recent interview on Radio 702, Avishal Seeth, Head of Retirement Consulting at Alexforbes, engaged in a thought-provoking discussion. The topic at hand? South Africa's new two-pot retirement system—a significant change that impacts every individual's financial future.

As we approach the implementation date of the new two-part retirement system, it's essential to understand how these changes will impact your retirement savings.

What you need to know

What is the two-part system, and how does it work?

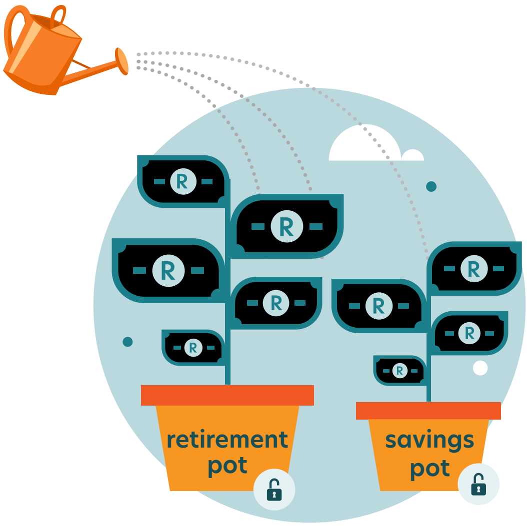
As of 1 September 2024, any contributions made to retirement funds will be split into two distinct components, or "pots":

Retirement pot: Approximately two-thirds (67%) of your contributions will automatically flow into this pot. Importantly, you won't be able to withdraw from this portion until retirement. Your contributions, including investment growth, will be preserved in the retirement pot and annuitised at retirement – essentially buying a pension. This means ensuring you receive a monthly income to set up your retirement.

Savings pot: The remaining one-third (33%) will find its place in this pot. Unlike the retirement pot, you can access the savings pot as a cash lump sum once a tax year if necessary. Your contributions, including investment growth, will be housed in the savings pot and accessible to you provided the amount is not less than R2 000 and only one withdrawal per tax year will be allowed.

Existing savings, up to 31 August 2024, including any investment growth on these savings won't be affected by the new rules, except for one small exception. Can you explain that?

Yes. So here's the key detail: A small amount of your savings from your existing savings - also known as your "vested" savings - will be moved into your new savings pot. Specifically, this amount is expected to be 10% of your savings, limited to R30 000. Let me break it down further: initially, this small amount will be provided as a once-off transfer from your vested savings, effectively seeding your new savings pot with 10% of your vested savings up to 31 August 2024 and limited to a maximum of R30 000. It's a crucial aspect of the transition to the two-part system.



What is the new two-pot system looking to achieve?

I believe there are two key reasons behind the changes made by the National Treasury. Let's delve into them:

Increasing retirement income: The first and most crucial reason is to actually increase the retirement income that individuals receive when they retire. Here's the situation: As they move jobs, they often cash in their retirement savings, which affects the amount of money they will have for their retirement. Because of this, individuals often don't have enough to live on when they retire. The new legislation introduces something called compulsory preservation, which the industry has been advocating for. Under this system, two-thirds (2/3) of your future contributions won't be accessible until retirement. This approach aims to significantly improve long-term outcomes.

Acknowledging financial challenges: However, we can't ignore the fact that many individuals face financial challenges even before reaching retirement. The reality is that we all have unexpected expenses or emergencies that we aren't prepared for. Interestingly, when we look at the industry as a whole, 95% of members don't have significant savings outside of their retirement fund. Given this reality, it makes sense to allow access to a small proportion of their savings in getting through financial challenges when they have no other options.

In summary, the two-part system strikes a balance between securing savings intended for retirement and addressing immediate, short-term financial needs. It's a delicate dance, but one that aims to benefit members in the long run.

A lot of South Africans are battling to make ends meet. Is it risky for individuals to dip into the savings pot?

It's crucial to emphasise that the savings pot is reserved for genuine emergencies. Withdrawing cash from the savings component should be considered as a last resort. The intention behind the two-pot system is certainly not to encourage frivolous spending. Having said that, we have to understand the reality of financial strains most South African are experiencing. Individuals will not only need greater access to financial advice to help them understand their motivations for accessing their savings pot but also to help guide them in utilising it responsibly. This way, individuals can feel confident that they're making the most of their money and improving their financial outcomes. I believe that this is where Alexforbes can make a real difference in people's lives.

What are the not-so-known implications of dipping into one's savings pot?

Withdrawing cash from the savings pot has financial implications, including paying tax on any amount withdrawn, reducing future overall retirement income, and reducing the cash amount available at retirement. The retirement system is complex. Before making any withdrawals from their savings pot, it's critical for individuals to understand their options so that they can make informed decisions about their retirement savings. The right financial advice at the right time can help individuals make decisions confidently once they have a better understanding of the consequences associated with the different options.

Planning for a comfortable retirement. What's the magic number?

A general rule of thumb is to save 15% of your income per month consistently over a period of 40 years. I understand this can be difficult given our environment—high unemployment rates and soaring interest rates. But these sacrifices are necessary for a healthy retirement in South Africa.

15% over 40 years

There has been talk about the two-pot system in Parliament, and there is a general consensus behind its purpose and implementation. Are you going to meet the 1 September 2024 deadline?

It has indeed been challenging. We experienced a postponement from 1 March 2024 to 1 September 2024. Initially, there were even discussions about implementing this system in 2023. Throughout the process, Alexforbes has continued to engage with National Treasury, the Financial Sector Conduct Authority, the South African Revenue Service and industry bodies. These reforms represent significant changes to the retirement system, with substantial implementation requirements. From a business perspective, we've geared up—developing administration systems, enhancing communication, and more. I believe we'll be ready. We're supportive of this change and well on track.

There's been a lot of rumours and inaccurate information surrounding the details of the two-pot system, its implementation, and what it means for individuals and their retirement savings. Is there a place where individuals can receive reliable and accurate information on the two-pot system?

Yes. Navigating the two-pot system can be confusing, and we're here to make it easy. We have curated a webpage specifically dedicated to two-pot on our online **My Money Matters portal**. Here, individuals have access to clear and up-to-date communication and information that will guide them step-by-step, helping them grasp the impact on their retirement savings. We encourage individuals to explore, engage, and leverage these resources to their advantage and find the answers they seek.