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Analysis of the two-pot retirement system and its implications on the system of social security in South Africa

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1 Introduction

Social security law forms integral part of the Bachelor Laws (LLB) and Masters of Laws (LLM) curriculums. Social security is a system of measures designed to support individuals experiencing, or at risk of income loss from paid employment or facing some financial burdens.[1] Social Security Law is offered in both LLB and LLM curriculums, which covers social assistance and insurance. Social Security is offered in all most all universities in South Africa as an elective or compulsory course in the undergraduate LLB degree curriculum.

The Two-pot system is part of social insurance which provides for early access of retirement funds for members of pension funds. By discussing this topic in this chapter, the intention is to impart knowledge to students, practioners, retirement funds, trustees and retirement funds administrators on how the two-pot system alleviate distress and financial burdens of the contributing members. In addition, this chapter

1 D Pieters 'Introduction into the Basic Principles of Social Security' (1993) 2. According to Liebenberg, social security encompasses such terms as 'an adequate standard of living' and 'a social safety net against destitution' (Davis D et al *Fundamental Rights in the Constitution* (1997) 356-357.

will discuss recent developments on the current and future trends and pedagogy on the two-pot system and its effect on social security.

The pedagogy and practice of the two-pot system is shaped by the principles of social security. In other words, two-pot system is contributory in its nature wherein members and employers contribute towards retirement funds can access some of the funds when needed instead of taking loans. The intention is to provide members with safety net during emergency.

The South African system of social security is based on universal principle by which everyone has access to social security.[2] South Africa offers various retirement savings mechanisms, such as pension funds, pension preservation funds, provident funds, provident preservation funds, and retirement annuity funds.[3] In the past, these funds had unique tax implications for contributions and distinct rules for withdrawals. To encourage retirement savings, there have been notable changes to the retirement savings framework since 2012. Key changes encompass standardising tax implications for contributions across different fund types, effective from 1 March 2016, and enhancing fund preservation by aligning annuitisation requirements at retirement for all retirement funds, implemented on 1 March 2021.[4]

Under the existing retirement system, individuals can completely withdraw from their pension or provident fund upon ending their employment.[5] Additionally, individuals can also make once-off withdrawals from their pension preservation or provident preservation funds.[6] The government had a concern as many of these withdrawals are happening regardless of the tax rates imposed on them. That called for development of the current retirement system.

The two-pot retirement system is a system where investors are able to save up to one-third of their retirement contributions in a 'Savings Pot' that one can access over a 12-month cycle; two-thirds of the contribution

2 Section 27(1)(c) of the Constitution, 1996.
3 National Treasury 'Draft explanatory memorandum on the revenue laws amendment bill' (2023) GG 3. See also Hirschbeck *Encouraging individual retirement savings in South Africa* (Doctoral dissertation 2014 Rhodes University); and Moleko *Pension fund reform towards development of national economy: A South African case study* (Doctoral dissertation 2019 Stellenbosch University).
4 As above.
5 As above.
6 As above.

will be allocated to a 'Retirement Pot'.[7] One-third (or 33.33 per cent) of the retirement savings, known as the savings pot, will be available for emergency use.[8] The other two-thirds will be reserved in the 'retirement' pot, which will be untouchable until one's retirement.[9]

This system in its nature promote access to social security as an individual can access funds when in need, both during the subsistence of employment and during retirement. The implementation of this system is anticipated to commence on the third month of 2024. Thus, contributions to the 'Savings Pot' will commence only after this date, which is set for 1 March 2024.[10]

Members or investors can access their savings pot just once a year, with the lowest withdrawal set at R2 000.[11] They can withdraw either a portion or the entire amount accumulated in the savings pot up to the permitted withdrawal date annually.[12] There will also be a vested pot, which will contain the retirement savings amassed prior to the introduction of the two-pot system.[13]

The National Treasury suggested taxing individuals at their marginal tax rate for these withdrawals, in contrast to the present system.[14] In the current system the pre-retirement withdrawals made before reaching retirement age attract higher tax rates. These modifications will impact all types of retirement savings, encompassing company funds, umbrella funds, retirement annuities, provident funds, and the Government Employees Pension and Preservation Funds.[15] To minimise the negative impact on liquidity, it is suggested that seed capital should be determined

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7 Easy Equities 'All you need to know about the new 2-pot system' (2023) *All you need to know about the new 2-pot system* (www easyequities.co.za) (accessed 9 August 2023. See also Burger 'Two-pot retirement system in South Africa' 2023 *TAXtalk* 24-25.

8 Funani 'Understanding the retirement reform two-pot system: How will the proposed legislation impact your retirement savings?' (2022) *Understanding the retirement reform two-pot system* (www.nfb.co.za) (accessed 9 August 2023).

9 As above.

10 Easy Equities 'All you need to know about the new 2-pot system' (2023) < All you need to know about the new 2-pot system (easyequities.co.za) > accessed 09 August 2023.

11 Funani (n 8).

12 As above.

13 Fraser 'South Africa's new 'two-pot' retirement system – start date and other proposed changes detailed' (2023) *BusinessTech* (accessed 9 August 2023).

14 As above.

15 As above.

as ten percent of the accumulated benefit in the 'vested component' as of 1 September 2024, capped at R25, 000, whichever amount is lower.[16] It is crucial to understand that when a retirement fund member withdraws this seed capital, it will be taxed at the standard rates applicable to the member.[17]

This chapter amongst other things provide analysis of the two-pot retirement system. This chapter also discusses the implications of the proposed system on the South African social security system. The chapter concludes by stating why the new system has a good impact on the employee's social security.

2 The concept of social security and its relevance to the two-pot retirement system

According to Talane, the social security system in South Africa comprises four major elements, namely private savings, social assistance, social insurance and social relief.[18]The focus of this chapter is on the private savings relating to the two-pot system. The purpose of pension insurance schemes is to replace income when the old-age contingency occurs.[19] Members of retirement funds are encouraged to preserve their retirement savings until reaching a retirement age. The two-pot system is meant to help fund members in times of financial difficulty by allowing access to the savings component before retirement. It is advisable that members use the savings component sparingly and only when there is a dire need.

The two-pot retirement system is a reform that will allow retirement fund members to make partial withdrawals from their retirement funds before retirement, while preserving a portion that can only be accessed at retirement to help improve retirement outcomes. This means members need not resign to access part of their retirement benefit if they are in financial distress. This reform will come into effect on 1 September 2024.[20]

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16 Fraser (n 13).
17 As above.
18 C Okpaluba *Law and contemporary South Africa society* (2004) 219 in a book chapter written by JS Talane *Incorporating informal social security into mainstream social protection*.
19 Okpaluba (n 18) 230.
20 National Treasury *Frequently asked questions two-pot retirement system* August 2024.

3 Reasons for changing status quo of the retirement system

The government has raised two main issues with the structure of the existing retirement system. Firstly, there's a concern about insufficient preservation of funds before reaching retirement.[21] When pension and provident fund members have the option to access their retirement savings upon ending their job, it might tempt them to quit merely to access these funds. This can prematurely disrupt the preservation of these funds until they reach the typical retirement age as stipulated by the fund's regulations.[22] Some provident fund members under financial constraints would retire early (upon reaching retirement age) merely to access the funds and later seek re-employment. This was the only option to have access to a sum of money without taking loans.

The government's second worry revolves around the fact that certain households facing financial difficulties possess assets in their retirement funds that they cannot tap into during emergencies or financial strain.[23] This issue has been magnified with the emergence of the COVID-19 pandemic, as there have been increasing appeals for individuals under financial duress to access their retirement savings to ease their monetary challenges.[24] The structure and accessibility of retirement savings in South Africa presents complex challenges that the government is grappling with. On one hand, there is the pressing matter of ensuring that individuals preserve their funds for retirement and do not succumb to the temptation of early withdrawals. On the other hand, the inflexibility of the system is evident in the face of dire financial situations, especially highlighted during the COVID-19 pandemic, when many sought the relief of accessing their savings. Striking a balance between preservation and necessary access is vital.

The concerns raised underscore the need for a holistic approach to retirement savings that both secures futures and provides a safety net in unprecedented times. While securing the future, the possibility of present unplanned emergencies should not be neglected or overlooked at.

21 National Treasury 'Draft explanatory memorandum on the revenue laws amendment bill, 2023' (2023) GG 4.
22 As above.
23 As above.
24 As above.

4 Three components within the retirement funds

4.1 Savings component

Under the updated system, from 1 September 2024 onwards, retirement funds were mandated to establish a segment referred to as the 'savings component' within the existing retirement fund framework.[25] Individuals' retirement fund members will need to allocate one-third of their total retirement fund contributions to this 'savings component'. This portion, equivalent to one-third of a person's retirement assets in the 'savings component', can be accessed before retirement.

Importantly, members will have the flexibility to draw from this 'savings component' without needing to end their employment.[26] Amounts contributed to the 'savings component' are accessible without the member having to resign or retire from their respective retirement fund. This safeguards the employment of members, as they do not have to retire to have access to their funds. A member will be allowed to make a single withdrawal within a year of assessment.[27] The minimum withdrawal amount is R2 000 while the maximum amount is capped at R30 000.[28] In the event that a member resigns from employment and such member has already made use of their single withdrawal, an additional withdrawal will be allowed provided the member's gross interest in their 'savings component' is less than R2 000.[29]

The ability to withdraw from the 'savings component' will be applicable per fund or per contract basis. Withdrawals from the 'savings component' will be added to the individual's taxable income and will be taxed at their marginal rate. In the event that a member dies, their beneficiary can opt to receive the benefit in the 'savings component' as either a lump sum, or they can transfer it to their 'retirement component' and receive an annuity.[30]

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25 National Treasury 'Draft explanatory memorandum on the revenue laws amendment bill, 2023' (2023) GG 5.
26 As above.
27 As above.
28 As above.
29 As above.
30 As above.

4.2 Retirement component

People will need to allocate two-thirds of their total individual retirement fund contributions to the 'retirement component'.[31] This segment, which contains two-thirds of a person's retirement assets, must be retained until they reach retirement. The funds in the 'retirement component' can only be accessed upon retirement.[32] When members achieve the retirement age, they will receive the amount from the 'retirement component' as an annuity, which includes living annuities.[33]

The existing threshold for converting annuities, currently set at R165, 000, will be relevant for annuities from this segment. The option to convert an annuity will be influenced by the member's assets in both the 'vested component' and the 'retirement component', evaluated for each fund. The existing guidelines about payments to beneficiaries when a member passes away will remain applicable for disbursements from the 'retirement component'; meaning, the beneficiary will persist in receiving an annuity.[34] If an individual decides to leave South Africa and no longer qualifies as a tax resident, they can access withdrawals from the 'retirement component' as a lump sum.[35] However, this lump sum withdrawal is governed by the 3-year rule that is presently applicable to members of retirement annuity funds, pension preservation funds, or provident preservation funds.

4.3 Vested component

Retirement funds are mandated to determine the value of a member's retirement interest on the day immediately preceding 1 September 2024, as these amounts will adhere to the existing retirement rules. The current regulations related to the 'vested component' will persist even after the 'two-pot' system is introduced.[36] Upon this system's inception, members will cease making contributions to their 'vested component,' except for

31 National Treasury 'Draft explanatory memorandum on the revenue laws amendment bill, 2023' (2023) GG 6.
32 As above.
33 As above.
34 As above.
35 As above.
36 National Treasury 'Draft explanatory memorandum on the revenue laws amendment bill, 2023' (2023) GG 7.

provident fund members who were 55 years or older as of 1 March 2021.[37] These particular members retain the option to keep contributing to their 'vested component' until they retire or exit the fund, they were part of on 1 March 2021. If they opt to keep adding to their 'vested component,' all of their contributions will go to this component, which means they would not contribute to the 'savings' and 'retirement' components.[38] However, those aged 55 or more on 1 March 2021 can still join the 'two-pot' system if desired, but doing so will stop them from adding to their 'vested component.'[39]

Funds within the 'vested component' will follow the current retirement framework. This encompasses features like single withdrawals from preservation funds, accessing pension and provident funds upon quitting a job, continuous safeguarding of vested rights due to the annuitization reform, and the compulsory annuitization of two-thirds of a member's retirement interest effective from 1 March 2021.[40] If someone decides to leave South Africa, making them non-tax residents, they can access the 'vested component' as a lump sum. Still, this withdrawal is bound by the 3-year rule currently in place for members of retirement annuity funds, pension preservation funds, or provident preservation funds.[41]

5 Implications and benefits on the social security system

5.1 Creation of 'seed capital'

This will allow for immediate access to the existing balance in the retirement fund when the 'two-pot' retirement system is introduced. 'Seed capital' is the initial balance in the 'savings component' as of 1 September 2024, which members of the retirement fund should be able to withdraw upon the 'two-pot' system's implementation.[42] This initial amount will be transferred from the 'vested component' to the

37 As above.
38 As above.
39 As above.
40 As above.
41 As above.
42 National Treasury 'Draft explanatory memorandum on the revenue laws amendment bill, 2023' (2023) GG 8.

'savings component'. To curb potential negative impacts on liquidity, it is suggested that the seed capital be set at ten percent of the 'vested component', capped at R30 000, choosing the lesser amount of the two values.[43] This approach ensures retirement benefits are not significantly depleted while still allowing pre-retirement access.[44]

5.2 Inclusion of defined benefit funds in the new regime

The proposal suggests that the 'two-pot' retirement system should also encompass defined benefit funds.[45] Therefore, defined benefit funds will need to compute the one-third contributions to the 'savings component' based on one-third of the member's pensionable service.[46] Similarly, the two-thirds contributions to the 'retirement component' will be derived from two-thirds of the member's pensionable service, effective from 1 September 2024. Regarding defined benefits, the seed capital should be determined as previously mentioned, and past service adjustments can facilitate this.[47]

5.3 Savings withdrawal benefit

From 1 September 2024 onwards, retirement funds will be mandated to designate a segment of the member's interest, termed the 'savings withdrawal benefit,' to the 'savings component.' This will be accessible for members to withdraw before their retirement without having to end their fund membership, under specific constraints.

The member's right is limited to one withdrawal during a year of assessment and where a member has multiple contracts in the same fund, the member may be allowed one withdrawal during a year of assessment from each of the contracts.[48] The value of each withdrawal before taking into account any charges or transaction costs may not be less

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43 As above.
44 As above.
45 National Treasury 'Draft explanatory memorandum on the revenue laws amendment bill, 2023' (2023) GG 9.
46 As above.
47 As above.
48 As above. See South African Revenue Services 'Guide to Complete the Lump Sum Tax Directive Application Forms' (2025) https://www.sars.gov.za/guide-to-complete-the-lump-sum-tax-directive-application-forms/ (accessed 10 June 2025).

than R2 000.[49] If a member resigns from employment within any year of assessment and such member has already made a withdrawal and the value of the members interest in the savings component is less than R2 000, such member may be allowed a second withdrawal of his or her total balance in the savings component.[50] A member should not have depleted their withdrawals before they are allowed to make another withdrawal.

5.4 Tax free transfers

Members can initiate the following internal fund transfers whenever they desire, and these transfers will be exempted from tax:

(i) From their 'savings component' to their 'retirement component'; and

(ii) From their 'vested component' to their 'retirement component'.[51]

Transfers between funds are only allowed when a member either resigns or retires from their specific fund.[52] If a member opts for an inter-fund transfer, all components must be shifted to the transferee's fund.

The following inter-fund transfers can be conducted without being taxed:

(i) From the transferor fund's 'saving component' to the transferee fund's 'saving component';

(ii) From the transferor fund's 'saving component' to the transferee fund's 'retirement component';

(iii) From the transferor fund's 'vested component' to the transferee fund's 'vested component';

(iv) From the transferor fund's 'vested component' to the transferee fund's 'retirement component';

(v) From the transferor fund's 'retirement component' to the transferee fund's 'retirement component'.[53]

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49 As above.
50 As above.
51 National Treasury 'Draft explanatory memorandum on the revenue laws amendment bill, 2023' (2023) GG 11.
52 As above.
53 As above.

As of now, members are taxed based on a specific tax table for withdrawals made before retirement.[54] Furthermore, upon retirement, the total of all past withdrawals influences the tax applied to any taken lump sum. However, with the introduction of the two-pot structure, this practice will undergo a transformation.[55]

While the current tax system will remain for the vested pot, withdrawals from the newly introduced savings pot will be viewed as added income.[56] This implies that if a member deposits into a retirement fund and later pulls out the same amount, the tax implications will balance out the tax reduction on the deposit will be equivalent to the tax charged on the withdrawal.[57] This new approach promises to be a more fair system.

5.5 Need for financial literacy

A more complex retirement system demands a higher level of financial literacy. Without proper education and awareness campaigns, many might not take full advantage of the system. A clear downside is the manner in which the system is complicated.[58] Each modification adds to an already intricate framework. A more complex system escalates costs and risks while simultaneously making it more challenging for individuals to comprehend its mechanisms and plan independently.[59] While we are confident that these alterations will enhance the system, the real challenge will be its resilience during future crises.[60] Merely adjusting the guidelines on preservation and cash access will not be a magical solution; the retirement fund system is not equipped to address numerous significant societal issues.[61]

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54 Carter 'Making sense of the proposed two-pot retirement system' (2022) *AllanGray*Allan Gray | Making sense of the proposed two-pot retirement system (accessed 13 August 2023).
55 As above.
56 As above.
57 As above.
58 As above.
59 As above.
60 As above.
61 As above.

6 Conclusion

While a two-pot retirement system could potentially offer several benefits to South Africa's social security landscape, it is essential to consider the unique challenges posed by the country's economic and social context. Proper implementation, inclusive policies, and robust regulatory oversight would be critical to its success. This is also a way to meet the minimum protection floor. To ensure that in the case of emergency, employees or fund members will be able to meet their needs. Having a broader base of people with savings can help the country weather economic downturns as people have personal financial buffers. By encouraging more savings, a two-pot system could ensure better retirement outcomes for many South Africans.

On the other hand, a significant portion of South Africa's workforce is in the informal sector. Ensuring these workers contribute to and benefit from the two-pot system would be challenging. Implementing a two-pot system would require robust administration and regulatory oversight. The country would need to strengthen its regulatory institutions to oversee and ensure that both pots are effectively managed. In essence, the two-pot system will impact on the South African social security more positively than it could be negative.

Currently, members of the public lack an understanding of the implications associated with early withdrawals under the new retirement system. This gap in awareness can lead to uninformed decisions that may negatively affect their long-term financial security. Legal practitioners have an essential role to play in bridging this knowledge gap by actively educating and advising clients on the legal and financial consequences of early withdrawals and other aspects of the new system. It is, therefore, imperative that the legal education curriculum be revised to incorporate detailed study and analysis of the new retirement framework. By integrating this subject matter into the study of pension law, we can ensure that future legal professionals are well-equipped with the knowledge and skills necessary to provide informed and accurate guidance. The curriculum update will ultimately strengthen the pedagogical foundation of the legal profession and enable lawyers to serve the public interest more effectively in matters concerning retirement planning.