



Financial Sector
Conduct Authority

FSCA COMMUNICATION 3 OF 2024 (RF)

Requirements for rule amendments to be submitted by retirement funds to give effect to the Two-Component System in terms of the Revenue Laws Amendment Bill and the Pension Funds Amendment Bill

1. PURPOSE

This Communication sets out the requirements of the Financial Sector Conduct Authority (“Authority”) regarding rule amendments to give effect to the two-component (‘two pot’) system and outlines the approach that the Authority will be taking to applications for such amendments.

2. BACKGROUND

2.1 The proposed two-component system is an important retirement reform aimed at addressing two challenges:

- (a) A lack of preservation (pre-retirement leakage) of retirement fund assets; and
- (b) Limited access to such assets in cases where members experience financial distress or emergencies.

2.2 The need for emergency funding was highlighted during the Covid-19 pandemic and resulted in stakeholders calling for members to have greater access to their retirement savings. In response to these calls, the National Treasury developed the Revenue Laws Amendment Bill (RLAB) and the Pension Funds Amendment Bill (PFAB).

2.3 Following extensive consultation and engagement, the Revenue Laws Amendment Bill (RLAB) will be finalised in Parliament shortly. The final iteration of the RLAB makes provision for the following:

- (a) Seeding capital, as a part of the savings component, consisting of 10% of the vested component of the member’s fund value, up to a cap of R30 000 (thirty thousand rand);
- (b) Application to all funds including defined benefit funds (also public sector funds);
- (c) Exemption for Legacy Retirement Annuity Funds upon application;
- (d) Deductions in terms of Section 37D of the Pension Funds Act, 1956 (Act No. 24 of 1956) (PFA) are provided for across all components (pots); and
- (e) An effective date of 1 September 2024.

3. REQUIREMENTS OF THE TWO-COMPONENT SYSTEM

3.1 The two-component system will require the rules of a retirement fund to distinguish and to stipulate the various types of benefits per the applicable regime as follows:

Vested and Non-Vested portions in Provident Funds (01 March 2021)

3.2 From 1 March 2021, provident funds were required to annuitise i.e., to provide an annuity at retirement for contributions made after 1 March 2021. Members of such funds, who were 55 years and older at that time, had their benefits ring-fenced and these are regarded as vested benefits. Such members retain their rights to elect to commute their full benefits in cash.

- 3.3 Provident Fund members who were 55 years or older on 1 March 2021 and who remained members of that fund until 1 September 2024 can choose to participate in the two-component system or remain as contributing members according to the pre-1 March 2021 regime.
- 3.4 Existing members' current benefits in retirement funds up to 31 August 2024 are to be excluded from the two-component system. No further contributions will be made to this vested pot.
- 3.5 The current regime in effect before 1 September 2024 will apply in respect of the vested component, which means that, for example, members will still be allowed to receive that vested benefit in cash on termination of employment before retirement.

Two-Component System (01 September 2024)

- 3.6 From 1 September 2024, all contributions flowing into retirement funds (pension funds, provident funds, preservation funds or retirement annuity funds), must in terms of the proposed amendments be allocated to two different components, a retirement component, and a savings component.
- 3.7 Fund rules will need to specifically cater for the above (i.e., one-third of the contributions to be allocated to the savings component and two-thirds of the contributions to be allocated to the retirement component) and permit members to have access to their benefits as appropriate.
- 3.8 The following principles as is being proposed in the RLAB and PFAB should be clear in the rules:

(a) Seed Capital Amount

The rules of a fund will need to provide for a seed capital amount or starting (opening) balance of 10% of the value of the member's share in a retirement fund immediately before 1 September 2024, subject to a maximum of R30 000 (thirty thousand rand). This requirement will not be applicable to the following types of members:

- Unclaimed benefit fund members;
- Pensioners;
- Beneficiary fund members;
- Members who, on or before 31 August 2024, had exited service and completed and submitted an election form; and
- Non-contributing members of terminating funds and funds in liquidation.

(b) Savings Component

The rules will need to provide for a savings component, to be made up of one- third of all contributions for the period, commencing 1 September 2024, together with any investment returns.

It needs to allow for an amount equal to or more than R2000 to be withdrawn once in any tax year.

The rules must stipulate that any withdrawals from the savings component before retirement will be taxed in terms of the PAYE tables and will be taxed in accordance with the retirement tax table if accessed in cash on retirement.

(c) Retirement Component

The fund rules will further need to provide for a retirement component that will not have any funds allocated to it prior to 1 September 2024 and will consist of two-thirds of contributions, together with investment returns thereon, accruing from 1 September 2024.

The rules will be required to stipulate that the funds in the retirement pot cannot be accessed

by members for cash withdrawals or upon resignation from employment and cannot be claimed as a cash benefit. It will need to stipulate that the amount must be used to provide an annuity subject to the de minimis amount and that the annuity will be taxed as and when it is paid to the pensioner.

(d) Requirements for Defined Benefit Funds

The rules of Defined Benefit Funds will be required to provide for the following:

- The existing requirement in terms of which the fund pays a pension on a member's retirement, determined according to a defined formula stipulated in the registered rules without referring to contributions by either the employer or member.
- a seed capital amount or starting (opening) balance, suggested to be 10% of the value of the member's share in a retirement fund immediately before 1 September 2024, subject to a maximum of R30 000 (thirty thousand rand).
- a clear indication that if a part of the savings component relating to the seed capital is paid to the member prior to retirement, the pensionable service of the member would need to be reduced to make this payment financially neutral to the fund at the time of payment. In this case, the valuator will be required to calculate the capital equivalent of the 10% of pensionable service prior to 1 September 2024 and one third of pensionable service after 1 September 2024, adjusted for any prior cash payments already made from the savings pot. This will be the value of the savings pot at the intended cash payment date.
- Once the member has decided on the amount to be paid, the valuator will be required to calculate the service given up by the member representing the value of the cash payment made and the reduced pensionable service that will be available at retirement in calculating the pension. The definition of pensionable service in the rules will also require amendment to allow for this.
- In respect of members of defined benefit funds withdrawing from their savings pot prior to retirement, the appropriate reduction of the period of service would have to be made.

Should the fund wish to adopt a different methodology, this must be approved by the Authority in advance, whereafter this must be clearly set out in the registered rules to give effect thereto.

(e) Transfers of components

The rules will further need to contain requirements relating to transfers. In particular, the following needs to be provided for:

- The transfer from the savings component to the retirement component.
- A prohibition on transfers into the savings component, other than from the seeding capital amount.
- Transfers of the savings components and retirement components across funds but must stipulate that they must be transferred together.
- The transfer of vested components subject to current rules.

As these transfers will be tax neutral there would be no need to make provisions in the new rules for related tax implications in terms of the Income Tax Act. . Benefit statements will need to be adjusted to reflect the applicable transactions.

(f) Deductions in terms of Section 37D of the PFA

The rules will need to provide that deductions in terms of section 37D will be effected

proportionately across the 3 components.

4. MEMBER COMMUNICATION

- 4.1 All retirements funds, save for the exceptions delineated in paragraph 3.8 above, are expected to communicate the proposed legislative changes to members in a manner which is simple, clear, and comprehensive and such communication must be timely and on-going as may be required.
- 4.2 The communication should, *inter alia*, alert members to the impact that any withdrawal from the savings component will have on the value of the member's benefit. This can be done by way of illustration using examples.
- 4.3 The Authority may request a copy of the communication issued by the fund or administrator to the members of the fund/s.

5. SUBMISSION OF TWO-COMPONENT AMENDMENTS

Please note that in the interest of the Authority considering application for amendments expeditiously, it is requested that all rule amendments in respect of the two-component system should be limited to the rule amendments delineated above. No other rule changes are to form part of such rule amendment submissions. This will save time on consideration of these cases because proposed changes would have been agreed upon in principle.

6. TRANSITIONAL ARRANGEMENTS

Where applicable, funds may apply for an extension of time in terms of section 279 of the Financial Sector Regulation Act, 2017. Any such application must be made in writing to the Authority.

7. ENQUIRIES

For further information regarding this Communication please contact the FSCA by emailing Ms. Fikile Mosoma at Fikile.Mosoma@fsc.co.za.



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