

South African Policing Union

Research report regarding:

- Retirement Reforms
- Inclusion of GEPF (Public Sector Funds) in COFI Bill & PFA
- Two Pot System Legislation
- Practical Effects of Proposals

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1. Introduction

The South African Policing Union was asked to submit a response regarding the publication of the draft legislation for the “Two Pot” Retirement System open for public comment of 09 June 2023.

The revised 2023 Draft Revenue Laws Amendment Bill incorporates the following key tax proposals that were mentioned in Chapter 4 of the 2023 Budget Review:

- Implementation date of the “Two Pot” retirement system.
- Proposal for seed capital.
- Legislative amendments to include defined benefit funds in an equitable manner.
- Treatment of legacy retirement annuity funds.

Extreme caution was advised in determining outcomes as the compound effect of a rushed decision might have disastrous consequences for members represented by the South African Policing Union.

With aforementioned, the current statistics show that an estimate of only 6% of South Africans can retire financially independent, those in the unfortunate position to form part of the remaining 94% might have to either, drastically cut living expenses, work beyond normal retirement age or depend on children to financially sustain them.

The proposed amendments were investigated to ensure that the South African Policing Union is aware of the impact which these proposed reforms would have on its members in a quantitative manner. The proposed reforms and legislation changes was extrapolated with several different aspects of scenario planning to illustrate the real or net effect of these proposals over the long-term for individuals. The real effect of proposed legislation was derived to illustrate that there would in theory be a “Three Pot” system, which is made up by the Vested Benefit Pot, Savings Pot, and the Retirement Pot.

It is understood that the intention of the proposed amendments is to allow enhanced preservation of retirement benefits which will ensure that more members can retire financially independent, but also to allow for some sort of flexibility, access, or emergency funds without termination of employment or eroding of their pensionable interest for extreme events such as the Covid 19 pandemic.

It is an extremely difficult tight rope to navigate to find the equilibrium for all stakeholders involved. Thus, we have done an in-depth analysis of the effect of the proposed amendments, under certain assumptions, to hopefully provide clarity regarding the pros and cons of the proposed amendments on members.

We have also focused on the areas of concern highlighted by the South African Policing Union on which they would like clarity before submitting their official response.

2. South African Policing Union – Areas of Concern

- **GEPF Inclusion**

As per the Budget Review of 2022 the GEPF and Public Sector Funds were not initially included for the retirement reforms as it is governed by its own legislation. The proposed reform entails several complex aspects which must be attended to before the legislation can be included in the proposed consolidated “Retirement Fund Act”. Stakeholders involved includes National Treasury, GPAA, GEPF, the PIC and amendments to the current Pension Funds Act. There are several difficulties which must be approved or exemptions which must be applied for should the proposed amendments be accepted and given the time constraints; it seems very improbable that this would be concluded with sufficient time prior to the proposed implementation date of 01 March 2024.

- **Choice of Participation**

Draft legislation proposes that members of Provident Funds aged 57 years and older will participate in the two-pot system, unless they opt-out. They would need to exercise an option or submit notice whether they would like to participate in the system or not. If they opt out, they will not qualify for any of the annual withdrawals available from the “Savings Pot” and withdrawals would be subject to current existing legislation.

For members 57 and younger, proposed legislation entails participation in the “Two Pot” retirement system as mandatory.

- **Difference in Interest**

The South African Policing Union was concerned that members might be prejudiced due to possible difference in interest or growth earned on the retirement account if funds were pooled in one investment account compared to being split as proposed.

Comment:

Please refer to annexure B and C for illustration purposes. Compound Interest calculations were done to illustrate that, if the investment strategy for both “Pots” and investment portfolios used to facilitate the funds under management were equal, that there would not be any difference between combining investment funds in one platform compared to having it split according to the “two-pot” system.

- Annexure B illustrates the comparison between having two separate lump sum investments,

- R500 000.00 lump sum for each investment with no additional contributions.
 - 8% per annum assumed investment return.
 - 25 Year Investment Term
 - R3 424 237.60 illustrative investment value per portfolio
 - R6 848 475.20 total illustrative investment value of portfolio
 - Versus
 - R1 000 000.00 lump sum investment with no additional contributions.
 - 8% per annum assumed investment return.
 - 25 Year Investment Term
 - R6 848 475.20 illustrative investment value of portfolio
 - Thus, no difference in interest accrued on lump sum contribution if investment strategy is equal.
- Annexure C illustrates the comparison between having two separate recurring investment accounts (1/3rd Savings Pot, 2/3rd Retirement Pot) and one total contribution investment account,
 - R7 500.00 per month total contribution (1/3rd Savings Pot – R2 500.00 pm, 2/3rd Retirement Pot – R5 000.00 pm)
 - 8% per annum assumed investment return.
 - 25 Year Investment Term
 - R7 220 763.31 illustrative investment value – Retirement Pot
 - R3 610 381.65 illustrative investment value – Savings Pot
 - R10 831 144.96 illustrative investment value – Total Portfolio
 - Versus
 - R7 500.00 per month contribution
 - 8% per annum assumed investment return.
 - 25 Year Investment Term
 - R10 831 144.96 illustrative investment value – Total Portfolio
 - Thus, no difference in interest accrued on recurring investment contribution if investment strategy is equal.

- **Savings Pot Access**

The South African Policing Union questioned the proposed legislation regarding maximum withdrawal from the Savings Pot, being capped at R25 000.00 per financial year. It advised that it might be a better solution for members to have the unutilized maximum benefit for each financial year to accumulate annually and for the member to have full access to the accumulated Savings Pot value in any financial year.

Comment:

In theory the proposal regarding having a full withdrawal of the accumulated unutilized withdrawal benefit for each financial year of assessment makes sense. This would allow members to access a larger portion of their Savings Pot benefit, subject

to limits and hopefully motivate members to only access the Savings Pot in extreme circumstances. Thus, the larger withdrawal amount limited to accumulated unutilized annual withdrawal benefit would allow members access to a larger portion of the Savings Pot to attend to worst case scenario situations and equip them to settle immediate responsibilities.

The real risk implication of above proposal is the fact that as per proposed legislation, the proposed allowable annual withdrawal amount (limited to 10% or R25 000.00) and is proposed to form part of each members Personal Income for the year of assessment, thus the amount of R25 000.00 maximum being taxed according to each member's individual Marginal Tax Rate. If the proposed solution of "Full Withdrawal allowed on Accumulated Unutilized Withdrawal Benefit" is implemented, it could result in a situation where a member can lose as much as 45% of the total withdrawal due to the withdrawal forming part of the member's Annual Taxable Income (Annexure F). This would drastically erode the benefit and cause excess taxation liabilities for the member.

As we are of the opinion and in agreement with the South African Policing Union regarding the extra motivation such a proposal would provide for members to access the Savings Pot less frequently, the additional tax burden for having the full accumulated unutilized withdrawal benefit included in Personal Income Tax for that specific year of assessment would outweigh the benefit.

A possible solution for this might be for the withdrawals from the Savings Pot to be taxable in line with the existing Withdrawal Tax Table for Lump Sum Benefits (Annexure G) instead of forming part of a member's Personal Income Tax for the specific year as below. Proposed legislation already mentions that a withdrawal from the Savings Pot would require a Tax Directive from SARS, thus no additional administrative burden. Having the withdrawal assessed under the Withdrawal Tax Tables will result in significantly lower rates of tax levied against the withdrawal but will also act as additional motivation not to frequently exercise a withdrawal as it would be included for everyone's tax-free lump sum in terms of Retirement Planning.

TAX RATES		INDIVIDUALS - 2024	
Taxable income		Rates of tax	
R	0 - R 237 100	18% of each R1	
R	237 101 - R 370 500	R 42 678 + 26% of the amount over	R 237 100
R	370 501 - R 512 800	R 77 362 + 31% of the amount over	R 370 500
R	512 801 - R 673 000	R121 475 + 36% of the amount over	R 512 800
R	673 001 - R 857 900	R179 147 + 39% of the amount over	R 673 000
R	857 901 - R1 817 000	R251 258 + 41% of the amount over	R 857 900
R	1 817 001 +	R644 489 + 45% of the amount over	R1 817 000

WITHDRAWAL LUMP SUM BENEFITS

As from 1 March 2009, the **taxable portion** of a pre-retirement lump sum from a pension or provident fund is the amount withdrawn less any transfer to a new fund **plus all withdrawal lump sums previously received**.

This amount is subject to tax at the following rates **less any tax on the previous lump sums which is calculated in accordance with the current table regardless of the tax actually paid on that lump sum**:

Lump sums accruing between 1 March 2014 and 28 February 2023

Taxable portion of withdrawal	Rates of tax
R 0 - R 25 000	Nil
R 25 001 - R660 000	18% of the amount over R 25 000
R660 001 - R990 000	R114 300 + 27% of the amount over R660 000
R990 001 +	R203 400 + 36% of the amount over R990 000

An assessed loss cannot be set-off against the taxable lump sum.

Lump sums accruing between 1 March 2023 and 29 February 2024

Taxable portion of withdrawal	Rates of tax
R 0 - R 27 500	Nil
R 27 501 - R 726 000	18% of the amount over R 27 500
R 726 001 - R1 089 000	R125 730 + 27% of the amount over R 726 000
R1 089 001 +	R223 740 + 36% of the amount over R1 089 000

An assessed loss cannot be set-off against the taxable lump sum.

- **Divorce Settlement Payouts**

The South African Policing Union raised concerns regarding the pensionable interest which is allocated to ex-spouses under a Divorce Settlement order. It proposed a solution where the pensionable interest allocated to an ex-spouse only becomes available to an ex-spouse to exercise option of payout, reinvestment into compulsory Annuity for income purposes when attaining the age of 55.

Comment:

The extract below from Divorces Act 7 of 1989 (Annexure H) the allocation of a pensionable interest to an ex-spouse according to the act states,

- ity or profit and loss and the accrual system are excluded. 10
- (8) Notwithstanding the provisions of any other law or of the rules of any pension fund—
- (a) the court granting a decree of divorce in respect of a member of such a fund, may make an order that—
- (i) any part of the pension interest of that member which, by virtue of subsection (7), is due or assigned to the other party to the divorce action concerned, shall be paid by that fund to that other party when any pension benefits accrue in respect of that member; 15
- (ii) an endorsement be made in the records of that fund that that part of the pension interest concerned is so payable to that other party; 20
- (b) any law which applies in relation to the reduction, assignment, transfer,

The Government Employee Pension Law governs the Government Employee Pension Fund and was amended on 24/06/2011 to allow for the “Clean break” principle to allow for divorces settlement orders to be allocated to ex-spouses. Please refer to Annexure I. The existing rules only allowed for ex-spouse to receive portion of

member's interest after the exit of the member from the GEPF. This was challenged as being against the Constitution and the act was amended to allow for the "Clean break" principle.

- 1.2. The GEPL, currently, does not allow a former spouse of a member to claim a portion of a member's pension interest, in terms of a divorce order or an order for the dissolution of a customary marriage, soon after the divorce order or the order for the dissolution of a customary marriage is granted. The former spouse can only receive a portion of the member's interest after the exit of the member from the GEPF.
- 1.3. The Government Employees Pension Law Amendment Bill, 2011 ("the Bill") will amend the GEPL to provide for the implementation of the "clean-break" principle.
- 1.4. The Pension Funds Amendment Act, 2007 (Act No. 11 of 2007), incorporated the "clean-break" principle into the Pension Funds Act, 1956 (Act No. 24 of 1956) ("the PFA"), as section 37D(1)(d), (3)(b), (4) and (5). The "clean-break" principle allows for the non-member spouse to claim and receive a portion of the member's interest that is assigned in terms of the divorce order or the order for the dissolution of a customary marriage, soon after the divorce order or the order for the dissolution of the customary marriage has been granted. The former spouse does not have to wait until the member exits the pension fund.
- 1.5. Clause 3 of the Bill provides for the insertion of a new section 24A into the GEPL, to provide for the implementation of the "clean-break" principle. The new section 24A will bring the GEPL in line with what is currently provided for in the PFA.

6. CONSTITUTIONAL IMPLICATIONS

The amendments in the Bill that seek to provide for the implementation of the "clean-break" principle will address the disparity regarding the implementation of the "clean-break" principle between the GEPF and other Pension Funds that are regulated in terms of the PFA. This has been the subject of a constitutional challenge in the High Court case of *Mathilda Wiese and the GEPF and others*.

Taking above into consideration the recommendation would be that the proposal by the South African Policing Union to have the ex-spouse member interest portion only available for option once attaining age 55 would not be possible.

We did however identify several other issues pertaining to Divorce orders in the Private Sector which might be raised when proposed amendments is to consolidate all legislation under the "Retirement Funds Act."

Current Divorces Issues

Pension interest:

- Retirement Annuity: Contributions + Simple interest capped at fund value **as at date of divorce**
- Preservation Fund: Withdrawal benefit as at date of divorce
- Pension and Provident Fund: withdrawal benefit as at date of divorce, as if the member had resigned on that date
 - Requires current fund membership by virtue of employment.
 - So: "in fund preservation" members don't have "pension interest"

If the member is in the process of getting divorced and resigns prior to divorce, even if benefit still in the fund (pending e.g., transfer to a preservation fund) – no pension interest.

- Attorneys and advocates continue to get “pension interest” wrong.
- Matrimonial property regime is relevant (only applicable is COP or ANC with accrual) (Section 7(8) of the Divorce act)

- **Pensionable Years of Service**

The proposal of the South African Policing Union was for the number of Pensionable Years of Service completed, which was lost due to the possible annual withdrawal from the Savings Pot, not to affect the total years of completed service when determining the final Retirement benefit, Gratuity Amount and Life Annuity income payment. This would be done by allowing the members to purchase additional service years completed by means of additional monthly contributions towards the fund.

Comment:

Under the current GEPF laws, it is possible for a member to request to purchase additional years of completed service by means of additional contributions towards the fund. As the GEPF is a Defined Benefit Scheme, according to actuarial calculations, in a typical formula you would get roughly 2% of your final salary for each year of pensionable service completed. Thus, if the member has 40 completed pensionable service years, the member will receive roughly 80% of his final salary as in income for life, with certain limits on inflation protection included.

By referring to Annexure D, this is a graphic illustration of how a member choosing to exercise the full Savings Pot withdrawal amount of R25 000.00 annually as per current legislation, with the assumption that the R25 000.00 annual limit would be adjusted every 5 years by 10% increase to allow for effects of inflation.

This analysis indicates that a member, starting at age 25 in the public service, who completes 40 years of Pensionable Service, but accessing the maximum annual amount from the Savings Pot, will effectively stand to lose 10.21 years of completed service due to the regular annual withdrawals. This equates to a 25.53% lower income in retirement, and the same applies to Gratuity payable. This significant reduction in pensionable income is compounded by the effect of annual inflation, the average rate over the past 20 years being 5.04% over the period (Annexure J).



Thus, the proposal of still being able to repurchase completed years of pensionable service is advised, from a practicality point of view it might become financially impossible to recover all the years of service lost due to continuous withdrawal from the Savings Pot, ultimately having a massive impact on the final completed years of pensionable service.

- **Members Resigning and Reapplying**

The South African Policing Union is concerned by the volumes of members who under current legislation resign from employment with the sole intention of accessing their Retirement Fund benefits through a Withdrawal prior to age 55, afterwards reapplying for the same employment.

Comment:

This is one of the biggest problems that the Government is facing at this stage regarding retirement funds and the massive shortfalls for members. This problem exists in both the Public Sector and Private Sector. The first step towards curbing this trend was the implementation of T-Day where existing Provident Funds at implementation date was still applicable to the full commutation rules at retirement, all additional contributions after T-Day would form part of the normal Pension Fund Rules at retirement.

The proposal of the “Two-Pot” System would be a further step in the direction of assisting members to preserve their retirement benefits. Under the proposed legislation, funds within the Savings Pot would be available to withdraw as per the annual withdrawal limit of R25 000.00 upon resignation, but the larger portion of contributions (2/3rd) would be allocated to the Retirement Pot which is only accessible upon retirement or death. This might discourage members to resign from their employment for the sole purpose of accessing accumulated retirement funds,

- Members would have emergency funds access to the R25 000.00 taxable.
- By not resigning it would be increasing years of pensionable service.
- It would be increasing contributions towards retirement fund.
- Decrease in excess taxation levied upon large withdrawal lump sums.

In our opinion, the proposed changes regarding the Two Pot system would be beneficial and be a motivating factor for members not to resign, just to benefit from the withdrawal of retirement funds, effectively eroding life savings and making it impossible to recover from. Please be advised that under proposed changes, Retirement Funds which still form part of the “Vested Pot” will still be eligible for full withdrawal prior to retirement.

- **Creditors Paid Directly**

The question was raised if it was possible for a creditor to be paid directly from the withdrawal or retirement benefit received by a member.

Comment:

Under the Financial Intelligence Centre Act, payments to any third party apart from the beneficiaries of the member upon death is prohibited. Under the amendments to the Pension Funds Act, they speak to “Housing Loans Capped” 65% but this should still be clarified, and this issue might be something that may have a massive influence in the proposed changes to the consolidated Retirement Fund Act.

- **Decision between current GEPF and Private Sector Funds**

The ultimate decision that the South African Policing Union is faced with is to accept or challenge certain aspects of the proposed retirement reform changes. The decision should be in the best interest of all members.

Comment:

One would only be able to make such a decision by taking a holistic view of the current benefits, proposed changes, and the compound effect this would have on members.

Pros of the current GEPF membership

All GEPF benefits are defined in the Government Employees Pension Law and rules, this is why GEPF is called a defined benefit fund. The benefit of belonging to a defined benefit fund is that your benefits are guaranteed for life, and not dependent on the performance of the financial markets such as the All-Share Index, Top 40 etc. or any individual investments within the GEPF.

A member receives a guaranteed pension on upon retirement age, regardless of what happened in the investment markets prior to the years of retirement, thus eliminating any investment risk for retirees. The GEPF Annuity Income benefits are also protected against inflationary risks. Member’s ultimate retirement wealth is safeguarded against inflation through a proper track record in terms of performance by the GEPF.

According to GEPF fund rules, the annual pension increase paid to its pensioners must be at least 75% of the average increase in consumer inflation from December 1 to November 30 of the previous year. The members' pensionable interests are safeguarded as the fund has very strict rules about the kind of benefits they must pay and how they must invest. These rules are contained in the Government Employees Pension Law, Proclamation 21 of 1996, and rules issued thereunder. Your own contributions to your retirement fund, plus your employer contributions to your retirement fund, are tax-deductible up to certain limits.

The GEPF has an extremely good track record of providing very competitive Life annuity income rates for the members who retire with the GEPF. Providing advice to members from a Private Sector point of view, it is very seldom that the Guaranteed Income for Life Annuity rate available in the Private Sector outperforms the rate available from the GEPF.

Benefits received from the GEPF in terms of employer contributions towards the GEPF Retirement Fund is also high compared to what is the average employer contribution towards retirement funds in the Private Sector. Up and above the high employer contribution, members are also allowed to buy additional years of pensionable service which can have a massive positive impact upon retirement.

Cons of the current GEPF membership

Unfortunately, currently the retirement age of a member is set out in the rules of the fund, and you only have the option or age to retire as set out by the GEPF. In the Private Sector, you have options of when you would like to exercise your retirement option with investment vehicles such as a Retirement Annuity being open ended after age 55.

With the GEPF, there is no flexibility in the way a member will receive the pension income for life. It is not possible to increase or decrease your pension income in line with your financial situation. There is also no option of leaving a legacy, example a child's bequest, as the pension income is payable for life, once the longest surviving spouse has passed, the benefit ceases.

In the Private Sector, there are several platforms to utilize to assist with flexibility on income payments such as a Living Annuity, where the funds are invested in the investment markets, Income is chosen as a percentage of 2.50% minimum to a maximum of 17.50% per annum drawdown of the capital value. Returns on the investment is market related and not guaranteed. In the event of death, the full fund value of the investment is paid to the nominated beneficiaries.

Conclusion

The intention of the proposed amendments is with merit to ensure that at all costs, members are motivated or assisted to preserve retirement funds. This will result in less unnecessary resignations, disruptions in employment and longevity of the work force.

Under current economic conditions experienced over the past several years, and what is transpiring in the world at large, having safety or surety with an extremely competitive Guaranteed Income Annuity for Life with inflation protection might just outweigh the pros of investing solely into Private Sector Funds. There are several ways to attend to the minor shortfalls of retiring with the GEPF through proper personal financial planning.

The proposed transition will have immense administrative burdens for all stake holders but in theory the intention of preserving retirement funding through these proposed changes does have merit. This can be illustrated in the scenario planning modules calculated, but extreme caution is given against unnecessary withdrawal from the Savings Pot, as it can have a disastrous impact on retirement income which is almost impossible to reverse.

If the proposed Inclusion of the GEPF in the COFI Bill and Pension Funds Act to form a consolidated Retirement Fund Act is done with care, the proposed Two Pot Retirement System may indeed be beneficial, with some small changes as mentioned within the report.

Since the GPAA must become licensed and the implications for the GEPF, would entail greater governance and accountability regarding having to comply with,

- Fit and Proper Requirements
- Appointment of GEPF Board procedures should be aligned with PFA.
- Reporting Requirements (Currently no requirements apart from Financial Statements and Annual Report to Minister and Parliament)
- FSCA Approval Required – Will ensure transparency and accountability.

If the above-mentioned can be achieved and the GEPF, after all proposed changes, would still be in the same financial position to provide its members with the same existing benefits, whether Private/Public Sector the proposed changes in theory would be beneficial to all members of the fund, reducing the strain on Government in the form of less Pensioner Grants required for elderly who don't have sufficient savings and enhancing the living standards of pensioners through preservation of their life savings.

Caution is advised in terms of the administrative burdens and practical implications of all the proposals on both the Public and Private Sector Funds. Reflecting on past experience through the implementation of T-Day legislation and several delays in final implementation. It is highly unlikely that all stakeholders would agree to all the proposals prior to implementation date of 01 March 2024. If the proposed changes can be identified, agreed

and sufficient time to implantation is left, it might be feasible, but at this stage there are several aspects which require clarification from the Private Sector.

Thus, even though there will definitely be benefits through some of the proposals, in our view it will not be attainable within the required timeframe. Submission of the issues identified might take several months to report back on and it is highly likely that the implementation date would have to be postponed allowing further discussion between all stakeholders.

