



THE COST OF THE TWO POT SYSTEM

EFFECTS OF THE TWO POT SYSTEM

The Two Pot system, which came into effect on 1 September 2024, has drawn much concern that Savings Component withdrawals by members will reduce their future benefits on retirement. This is, however, counterbalanced by the fact that members may be able to reduce their current level of financial distress and that the mandatory preservation of member's Retirement Components will, over time, increase member benefits and replacement ratios on retirement.

The lead up to the Two Pot system has also had the following positive effects:

- ❖ A huge upsurge of interest and (hopefully) understanding by members of their retirement and other fund benefits. Historically many members put off thinking about their retirement benefits until shortly before retirement. We suggest funds should capitalise on this interest, by considering further member communication and information on issues such as the types of annuities that can be purchased on retirement, the projection of benefits to retirement age and the risks of taking regular Savings Component withdrawals.
- ❖ A material improvement in the member contact information held by retirement funds which should allow for better communication and the digitisation of issues such as benefit payments, member trustee elections and the distribution of member benefit statements.

CHANGE IN THE NATURE OF ADMINISTRATORS

The requirement for administrators to pay Savings Component withdrawals has fundamentally changed the nature of these administrators to where they now have to also fulfil the role of a "bank" where members can make periodic cash withdrawals. In reality, many members may have higher amounts in the Savings Components than they do in their bank accounts.

The administrators should therefore have implemented stringent processes and security checks to prevent the possibility of fraudulent Savings Component withdrawals. We suggest that retirement funds request their administrator to confirm:

- ❖ What security checks are in place; and
- ❖ Who will carry the cost, i.e. the member, the fund, the fund's administrator or the fidelity insurer (of either the fund or the administrator), if a fraudulent Savings Component withdrawal is paid.

SAVINGS COMPONENT WITHDRAWAL FEES AND INCREASED ADMINISTRATION FEES

The number and amount of Savings Component withdrawals shortly after 1 September 2024 (and in future tax years) is unknown at this stage, but is expected to be material. Various commentators have focussed on the tax that will be paid to SARS on these withdrawals, and the effect this will have on the economy, but the other "leakage" from the system will be the fees paid to administrators.

Savings Component withdrawals are a significant change for administrators who historically only paid benefits (other than in respect of divorce and maintenance orders) on the exit of members from funds. Under the Two Pot system, the administrators will pay benefits whilst the member remains a member of the Fund. This means there will be a large increase in the number of claims payments, possibly as high as 4 or 5 times the normal number of annual payments, and this will reoccur if members request a Savings Component withdrawal each year.

The administrators have had to change their administration systems to be able to administer member benefits within the various components, to verify the identity of the member requesting a Savings Component withdrawal, to process the requests and to effect the payments. There has thus been significant work and costs involved in developing and updating administration systems and processes for the Two Pot system. The ongoing work and cost involved will depend critically on any human involvement at the administrator (and the employer's Human Resources Department) with many administrators moving toward technology-based request processes through WhatsApp, mobile application or member website options.

Most of the administrators have therefore decided to charge an additional fee for Savings Component withdrawals and the additional administration costs of the Two Pot system (such as maintaining separate records of each Component and changes to communication such as benefits statements) by charging either a fee against each Savings Component withdrawal, an increase in the basic administration fee or a combination of the two.

SURVEY RESULTS

In order to help funds understand the competitiveness of the fees their administrator is charging, we have conducted a survey of medium and large commercial retirement fund administrators to determine the fees they will charge (including VAT where applicable) in respect of the Two Pot system, and particularly the fee for Savings Component withdrawals (SCW). The responses received are summarised in the table below (administrators that either failed to respond or requested to be excluded from the survey are not reflected in the table):

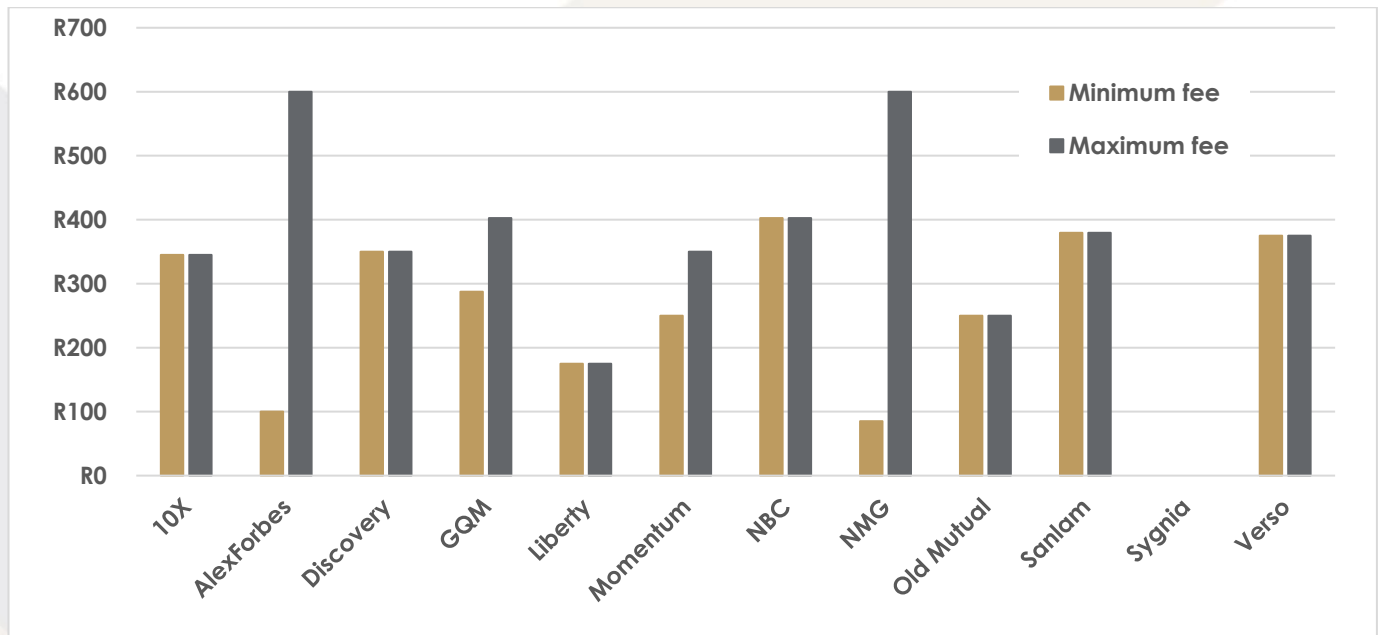
Administrator	SCW fee	Fee based on a SCW of R10 000		Fee based on a SCW of R30 000	
		Fee	% of SCW	Fee	% of SCW
10X	R345.00	R345.00	3.45%	R345.00	1.15%
AlexForbes	2% of SCW (min R100.00, max R600.00)	R200.00	2.00%	R600.00	2.00%
Discovery	R350.00	R350.00	3.50%	R350.00	1.17%
GQM	R287.50	R287.50	2.88%	R287.50	0.96%
Liberty	R175.00	R175.00	1.75%	R175.00	0.58%
Momentum	R250.00	R250.00	2.50%	R250.00	0.83%
NBC	R402.50	R402.50	4.03%	R402.50	1.34%
NMG	2.5% of SCW (min R85.00, max R600.00)	R250.00	2.50%	R600.00	2.00%
Old Mutual	R250.00	R250.00	2.50%	R250.00	0.83%
Sanlam	R379.50	R379.50	3.80%	R379.50	1.27%
Sygnia	None	R0.00	0.00%	R0.00	0.00%
Verso	R375.00	R375.00	3.75%	R375.00	1.25%
Average	R320.00				

Notes:

1. The fees are reflected, for illustrative purposes, on two sample Savings Component withdrawal amounts. In the future Savings Component withdrawal amounts could be higher than R30 000.

2. Where administrators manage both stand-alone and umbrella arrangements, they appear to be charging the same fee under both arrangements. Note that we have not specifically surveyed the fees charged in respect of retirement annuity funds and preservation funds.
3. Discovery will deduct the fee from the member's remaining Components after the withdrawal and not from the Savings Component withdrawal itself. All the other administrators have confirmed that the fee will be deducted from the Savings Component withdrawal itself.
4. GQM and Momentum will charge an additional R115 and R100, respectively, if the Savings Component withdrawal requires manual intervention by the administrator.

The minimum and maximum Savings Component withdrawal fees that will be charged by each administrator are as follows:



Most of the administrators are charging a flat fee irrespective of the value of the Savings Component withdrawal, whilst two administrations are charging a scaled fee depending on the value of the Savings Component withdrawal. Their average fee will depend on the profile of the actual Savings Component withdrawals of their respective administration books, but is likely to be in the same range as the flat fee for the other administrators.

The structure of the fee (fixed Rand amount or percentage of Savings Component withdrawal) will obviously affect members differently depending on the value of their Savings Component withdrawal.

OTHER FEE INCREASES

Three administrators have also explicitly confirmed that they will increase their base administration fee by between 2.80% and 4.00% on 1 September 2024 due to the implementation of the Two Pot system.

The other administrators have confirmed that their administration fees will not increase on 1 September 2024 (specifically as a consequence of the implementation of the Two Pot system), but several noted that they may increase their administration fee on the next fee review date once the actual profile and number of Savings Component withdrawals is known. We suggest each fund clarify what increase, if any, will apply for their fund.

Note that the above fees exclude other fees that have been incurred that are related to the implementation of the Two Pot system, such as communication and member information costs, drafting of rule amendments, any increase in fidelity cover premiums, etc.

TOTAL SAVINGS COMPONENT WITHDRAWAL FEES

The profile of Savings Component withdrawals by amount and by administrator is not known at this stage, but based on reasonable assumptions may average out at a fee of about R320 per withdrawal.

Based on an average assumed Savings Component withdrawal of, say, R20 000, the fee will then be an average of 1.6% of the amount withdrawn. A number of estimates of the total expected initial Savings Component withdrawals have been published, mostly in the range of R50 billion to R100 billion. Based on these estimates and excluding an estimate of withdrawals in respect of GEPF members, the Savings Component withdrawal fees that could be paid to administrators in the tax (part) year from 1 September 2024 to 29 February 2025 could be in the range of R640 million to R1.25 billion. Note that these amounts exclude any fees as a result of the increase in the base administration fee.

The number and value of Savings Component withdrawals in future tax years will depend on how quickly member's Savings Components rebuild with the one-third of future retirement funding contributions allocated to Savings Components after 1 September 2024. This in turn will depend on each member's salary and the member and employer contributions rates to their fund.

Assuming that most of the members who take a Savings Component withdrawal shortly after 1 September 2024, take a further withdrawal in each subsequent tax year, the direct Savings Component withdrawal fees could result in a fee to the administrators of some R500 million to R1.0 billion every year. This will represent a material windfall to the administrators and a consequent reduction to member benefits.

We would hope that all the administrators, once they have recovered any initial expenses of implementing the Two Pot system, assess their ongoing costs and, if applicable, adjust their Savings Component withdrawal fees appropriately.

IF YOU HAVE ANY QUESTIONS OR WOULD LIKE MORE INFORMATION ON HOW THE ABOVE MAY AFFECT YOUR RETIREMENT FUND, PLEASE CONTACT YOUR KEYSTONE CONSULTANT DIRECTLY.

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