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Part 1: Challenges and opportunities with South Africa's retirement fund system

While the South African retirement fund system faces its fair share of challenges, there are opportunities to harness and improve retirement outcomes for South Africans. In part 1 of our Two-pot chapter, Richard Carter, head of Assurance, discusses them.

South Africa's pension fund system has consistently produced inferior outcomes for its people, with the 2022 Mercer CFA Institute Global Pension Index ranking the country 34th out of 44 countries studied. Against this background, how will proposed changes to the country's pension fund system shape the retirement fund landscape? And, importantly, what can be done today to improve retirement outcomes for South Africans in the future?

While it is clear that South Africa's retirement system ranking is poor, with adequacy and sustainability of retirement benefits identified as weak links, the problem is multi-layered and complex.

It is important to understand that South Africa's retirement system does not operate in isolation. We are trying to problem solve in a highly unequal society where lots of people don't have jobs. We need to fix unemployment before we can really transform our pension fund system. If more people have jobs, it will increase the savings pool.

Overcoming the challenges

When it comes to those participating in the system, an area to prioritise is preservation. Currently, many people are getting to retirement with very little savings, not because they didn't participate, but because they didn't preserve enough.

In other words, it is the amount of money being paid out pre-retirement that undermines the system. For some, there is also an issue with contribution rates. People often don't know how much to save for retirement. This means even if they participate and never take money out, they still end up with too little at retirement.

Another challenge is that saving for retirement, by nature, is a long-term endeavour that plays out over decades. You have a system that has a tendency to be complicated, and every change made may have unintended consequences on, for example, investors' behaviour, which may take years to play out.

Two-pot retirement system: Moving in the right direction

The "two-pot retirement system", which has been proposed to be implemented in March 2025, will positively change behaviour if it delivers on its intention. The new system will require all new contributions made to retirement funds to be split into two portions: two-thirds will be allocated to a retirement component, which must be preserved until retirement, while the remaining one-third will be allocated to a savings component, allowing one withdrawal per tax year prior to retirement.

While many believe the two-pot system will allow investors access to more money, this is not necessarily the case. It recognises that people may have emergencies and need to access some funds; rather than having members resign to access their funds, thereby leaving their fund completely, the system will make a portion accessible.

The two-pot system will ration how much you can access while you are saving towards retirement. Overall, if the idea is implemented well, it will move us in the right direction. But as with everything, the devil will be in the details, including in the legislation. With the implementation date looming, there are risks to rushing the legislation.

There needs to be time for the industry to make the administrative changes and make them properly so that people retain their trust and confidence in the system. If you hurry the legislation through and rush the changes that need to be made, and you then cannot pay people what they expect, it can end up doing more harm than good.

Rethinking means test inclusions

According to Statistics South Africa, 73% of older persons in the country are beneficiaries of an old-age grant. The Older Person's Grant, also known as the state old-age pension, is a monthly payment made to qualifying individuals who are 60 years of age or older.

The means test determines who gets this grant, which is only available for people who receive a monthly income below a certain level. We believe that the means test needs to be reviewed, as it may currently act as an unintended disincentive to save towards retirement.

The means test effectively means that if you receive income from pension savings, you do not qualify for the Older Person's Grant. We should consider excluding pensions from the means test to remove the potential incentive to deplete your pension fund savings.

Incentivising better savings behaviour

Putting better retirement savings incentives in place will go a long way towards changing behaviour. The tax incentives on retirement products like retirement annuities are great, as are tax-free investment accounts, but these incentives only apply to the tax base.

In April this year, the South African Revenue Service announced that it had recorded a 4.53% increase in new personal income taxpayers, raising the active taxpayer base to just under 26 million. But, the population size of South Africa is just under 60 million.

With that being said, however, there are glimmers of hope in the country's retirement system. The governance of retirement funds is by and large good. There are many well-meaning and smart people looking after the savings of pensioners. We have a good savings and investment industry, not without its challenges, but there are opportunities.

Commentary contributed by Richard Carter, head of Assurance, Allan Gray