Discovery Invest

FUNDamentals

Retirement legislation reform:
with change comes opportunity

Government's reforms are changing the retirement savings landscape, with the ultimate aim of ensuring that you can adequately save for retirement and that your savings are properly protected. As part of Government's drive to get South Africans to invest more for their retirement, National Treasury has proposed broad policy reform, including the implementation of a mandatory retirement contribution system; improving pre-retirement savings preservation; introducing default annuity options; and simplifying retirement savings products. These changes are expected to come into effect during or after March 2015.

1. Simplifying tax deductions for retirement fund contributions

Contributions made to different retirement funds are taxed in different ways. Government plans to simplify this by introducing one calculation, which will apply to pension, provident and retirement annuity funds. From next year, you will be able to contribute up to 27.5% of your remuneration or taxable income (whichever is higher) to an approved retirement fund tax free. However, contributions will be capped at R350 000 per year and contributions made by your employer will fall within your 27.5% allowance, which means it can be included as part of your annual tax deductions.

Most South Africans fall within these limits, therefore, the majority of tax payers will benefit from increased tax deductibility when compared to the current tax regime.

Scenario 1: You earn R1 million per year of which 80% is pensionable income (PI)

Pension fund contribution	7.5% of R800 000 (PI)	R60 000
Retirement annuity contribution	15% of R200 000 (non-PI)	R30 000
Effective rate	**R90 000/R1 million**	**9%**

Scenario 2: You earn R1 million per year and only contribute to a retirement annuity fund

Retirement annuity contribution	15% of R1 million (non-PI)	R150 000
Effective rate	**R150 000/R1 million**	**15%**

Scenario 3: New contribution deduction limit of 27.5% on R1 million

Maximum contribution to all funds	27.5% of R1 million	R275 000
Effective rate	**R275 000/R1 million**	**27.5%**

2. Preserving your retirement withdrawal benefits

New legislation extends “annuitisation” rules that currently apply to pension and retirement annuity funds, to include provident funds. Provident fund members will only be allowed to withdraw one-third of their benefit as a cash lump sum at retirement. The remaining balance must be used to buy an annuity. Retirement fund divorce settlements (also known as pensionable interest) will be paid into a preservation fund rather than being paid out in cash at the time of divorce.

The one-third rule will only apply to contributions made after 1 March 2015 as well as on the returns earned on those contributions. Your vested rights (the balance of your provident fund on 28 February 2015 including any growth) remain under the old rules, and may be taken as a lump sum in full when you retire. Provident fund members who are 55 or older on 1 March 2015 are exempt from these provisions.

Withdrawal rules for preservation funds are also due to be amended from one withdrawal currently, which can be up to 100% of your retirement savings, to one withdrawal per fund per year, which can equal up to 10% of the fund’s value (per withdrawal).

3. Increasing the minimum tax threshold

If the value of your retirement fund is below the minimum threshold, you will not be bound by the one-third provisions mentioned above. This threshold has been increased from R75 000 to R150 000. If your total benefit at retirement in a specific fund is less than or equal to R150 000, you can take your whole benefit as a tax-free cash lump sum. If you have benefits in three different funds (such as a pension, provident and retirement annuity fund), each of which is less than R150 000, you will be able to withdraw all three benefits as a tax-free cash lump sum.

4. Providing a default annuity option for post-retirement

National Treasury's proposal requires that all retirement funds must have a default annuity product open to its fund members to encourage them to purchase an annuity when they retire. These default annuity products must meet acceptable principles and standards. The choice of an annuity and a product provider at retirement is critical to your financial security. Retirement funds will be required to provide free financial counselling to help guide you through the default annuity options and any other annuity options that suit your financial circumstances.

5. Making retirement saving mandatory

Recent research shows that more than three in four retirees are unable to maintain their pre-retirement standard of living. To address this challenge, National Treasury aims to ensure that all formally-employed workers save for their retirement by making retirement savings compulsory. However, these retirement funds must comply with the following criteria:

- **Efficiency:** They must ensure that distribution and administration costs of retirement funds are not unreasonably high, as members pay for these costs indirectly.
- **Convenience:** Employers should be able to provide retirement fund options to workers without placing an additional burden of costly financial advisers and complicated administrative processes.
- **Access:** Retirement funds must be able to provide low-income workers with access to their retirement savings during periods of unemployment.
- **Incentives for workers and their employers:** Identifying affordable ways of supporting the retirement savings of low-income workers.

National Treasury also believes the cost of saving in a retirement fund must be reduced. It proposes stricter control and better disclosure of product costs.

6. Implementing a tax-free savings account

In 2015, legislation will introduce tax-free savings accounts to encourage households to save more. These accounts will have an initial annual contribution limit of R30 000, and a lifetime limit of R500 000. These limits will be increased regularly in line with inflation. All returns and any withdrawals from these accounts will be exempt from tax.
To discourage individuals to use these savings for impulse purchases and to improve self-control, withdrawals can't be repaid. You will be allowed to open two accounts per year, and each account may hold either interest or equity investments, or both. In addition, interest exemptions will remain at R23 800 for taxpayers under 65 years and R34 500 for taxpayers 65 years and over. These exemptions will no longer increase from year-to-year.

How Discovery Invest is supporting a retirement savings culture

Discovery Invest is excited to announce the launch of its low-cost retirement savings product, the Discovery Top40+ Fund. This fund is ideal for aggressive investors who want to capture long-term growth linked to the performance of the FTSE/JSE Top40 Index, while benefiting from less volatility than a traditional direct Top40 Index investment. It is a low-cost equity fund with zero initial fees and competitive annual fees. Through the unique fee refund guarantee, Discovery Invest will refund you with the annual management fee if the fund doesn't outperform its benchmark (FTSE/JSE Top40 Index) in any year.

Take control of your retirement savings with Discovery Invest

While many of us put off saving for our retirement, starting too late means sacrificing your financial freedom. Government, with the help of its reform programme, is providing better support to help you make the right decisions and ensure that you have access to cost-effective retirement products. As part of this paradigm shift, Discovery Invest aims to make retirement saving easy and cost-effective with the launch of the Discovery Top40+ Fund. For more information about this low-cost equity fund or about our full suite of award-winning retirement and investment products, please visit www.discovery.co.za. Alternatively, you can speak to your financial adviser.

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