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The journey

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Accessing retirement benefits to alleviate the financial effect of lockdown

Speculation in the news about the possibility of allowing employed retirement fund members early access to their retirement savings following the lockdown period has abounded lately. Although Government has indicated that it has been considering the request of early access to retirement savings as a relief measure for members and that various stakeholders are being consulted in this regard, up to date, no policy decision has been made.

International trends

South-Africa is not the only country where some form of early access to retirement benefits has been considered or already has been implemented to deal with the devastating effect that Covid-19 has had on the economies of countries worldwide.

Australia[1]

Qualifying members of superannuation funds could access up to AU$10 000 (around R125 000) of their accumulated savings before 1 July 2020. From 1 July 2020 to 24 September 2020, qualifying members may access a further AU$10 000. Among other criteria, the following must apply in respect of the member |

- On or after 1 January 2020, the member’s job was either made redundant or his or her working hours were reduced by 20% or more.
- For sole traders, the business was suspended or there was a 20% or more reduction in turnover.

India[2]

Employees who contribute to The Employees' Provident Fund Organisation (the EPFO) can make a non-refundable withdrawal from the EPFO, equal to the lower of 75% of savings or three months’ wages and debarment allowances.

In addition, for April and May 2020, the Indian government made the full 24% contribution to the EPFO for employees of companies with up to 100 employees of whom 90% earn under INR15 000 a month (around R3,500). To further alleviate cash flow challenges, the contribution rate was reduced from 24% to 20% for May to July 2020.

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[1] Money Smart. Covid-19 Accessing your super. Retrieved 21 July 2020 from https://moneysmart.gov.au/covid-19/accessing-your-super

[2] Employees’ Provident Fund Organisation – India. Retrieved 23 July 2020 from https://www.epfindia.gov.in/site_en/covid19.php

USA[3]

Two options are available for qualifying members |

- Coronavirus-related distributions can be made from 1 January to 31 December 2020 to qualifying members. The total distributions from all funds may not exceed US$100 000 (around R1 700 000). For these distributions, the prescribed additional 10% tax penalty in the event of early access will not apply. The member will have the option to repay the distribution, in which case he or she can claim a refund of the tax paid.
- Provision for the following changes to loans from funds |
    - The repayment date for existing loans on or after 27 March 2020 with a repayment due date between 27 March 2020 and 31 December 2020 may be extended by 12 months. Payments after the suspension will be adjusted to indicate the period of suspension and to allow for interest during the period of the suspension.
    - For the period 27 March 2020 to 22 September 2020, the loan amount may be increased to the lesser of US$100 000 (around R1 700 000) or the vested value of the accumulated retirement savings of the qualifying member.

What is happening in South Africa?

Government could consider allowing one of the following options as proposed by various industry players to provide financial relief to members |

- A loan against accumulated retirement savings.
- A second withdrawal from preservation funds.
- A once-off pre-retirement withdrawal from retirement annuity funds.
- A special lump sum deduction from accumulated retirement savings in employer-sponsored retirement funds.

Let’s consider the proposed options |

Loan against accumulated retirement savings

On 18 September 2020, the Democratic Alliance (DA) published a Notice of Intention to introduce a Private Member’s Bill to amend Section 19 of the Pension Funds Act of 1956 (the Act). The proposed Bill aims to alleviate financial pressure during an emergency such as Covid-19 or similar by enabling retirement fund members to access a percentage of their retirement savings before retirement as guarantee for a loan.

Section 19 of the Act currently allows the provision of a pension-backed housing loan to retirement fund members and for the fund to provide surety to a third party for granting of a housing loan. These loans are referred to as pension-backed housing loans.

The DA is proposing that by enabling a member to access a pension-backed *lockdown* loan, members will be able to leverage their retirement savings before their retirement date, without eroding their retirement savings for the day of their eventual retirement. Lending institutions will be enabled to offer loans to retirement fund members at competitive interest rates and over extended or deferred payment periods, given that the loan is fully guaranteed by way of their retirement benefit.

Currently, all pension-backed housing loan applications are subject to the provisions of the National Credit Act of 2005 (NCA). The requirements of the NCA entail that the applicant of a pension-backed housing loan should

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[3] IRS Newsroom. Coronavirus-related relief for retirement plans and IRAs questions and answers. Retrieved 23 July 2020 from https://www.irs.gov/newsroom/coronavirus-related-relief-for-retirement-plans-and-iras-questions-and-answers

have enough disposable income to secure the repayment of the loan. If pension-backed *lockdown* loans are to be considered as the appropriate vehicle to relieve members' financial difficulties and if the provisions of the NCA were to also apply to such loans, it will result in very few members qualifying for such loans due to existing indebtedness and current reduced levels of income.

The current reduced levels of income increase the risk that members may fail to service the pension backed *lockdown* loans which can result in the loan being settled by a cash withdrawal from the fund. This will increase the current challenge of members having very poor retirement outcomes and the objective of the pension backed *lockdown* loans, being to assist members to not erode their provision for retirement, may likely not be achieved.

The DA invited comments from interested parties on the proposed Bill by 17 October 2020. Following the comments, a final proposal will probably be presented to Parliament for approval.

Second withdrawal from preservation funds

The Income Tax Act, 58 of 1962 (ITA), allows a preservation fund member one withdrawal from the preservation fund before the member reaches the age of 55. The amount withdrawn is taxed according to the income tax table applicable on withdrawal. The ITA also allows a member of a preservation fund to withdraw his or her full lump sum benefit from that fund even if the member has already exercised his or her once-off withdrawal option when the member emigrates from SA. This is subject to the emigration being recognised by the South African Reserve Bank for the purposes of exchange control, or when the member repatriates when his or her work or visitor visa expires.

The ITA currently does not provide for any further withdrawals from preservation funds. The ITA will therefore have to be amended to accommodate further withdrawals as an option to provide financial relief to members.

Once-off pre-retirement withdrawal from retirement annuity funds

In terms of the current provisions of the ITA, a member can only withdraw from a retirement annuity fund before retirement if he paid the full tax on the benefit and he is either formally emigrating, ceased to be an SA resident or his SA visa had expired. The ITA will therefore have to be amended to also allow access to benefits from a retirement annuity fund such as that allowed for preservation fund members. If this option is pursued, the minimum amount that must be kept in a retirement annuity fund, currently R125 000, must be considered. The concern however is that in some instances a reduction in benefits or the early termination of a retirement annuity policy may trigger a claw back of expenses and therefore further reduce the retirement outcomes of retirement annuity members.

Special lump-sum deduction from the accumulated retirement savings in employer-sponsored funds

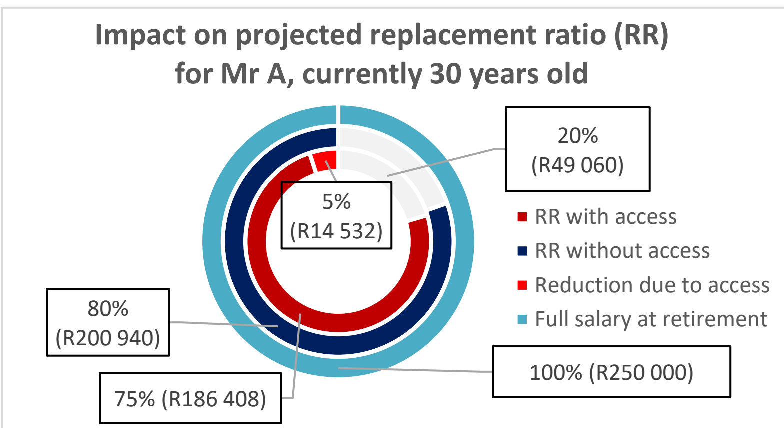
The retirement fund's rules will have to be amended to allow for a special lump-sum deduction from the accumulated retirement savings of a member who is in financial distress due to loss of or reduction in salary resulting from circumstances other than a strike or lock-out. In terms of the Act, the FSCA must approve a rule amendment if it is not inconsistent with the Act and does not affect the financial soundness of the retirement fund. As there is nothing in the Act that prevents a fund from amending its rules to provide for such special lump-sum deduction and as the financial soundness of a retirement fund will not be negatively affected if the rule amendment determines that the benefit payable to the member on exit from the fund will be adjusted by benefits previously received, the rule amendment should be approved by the FSCA.

Will the benefits be taxable and who should qualify for the benefit?

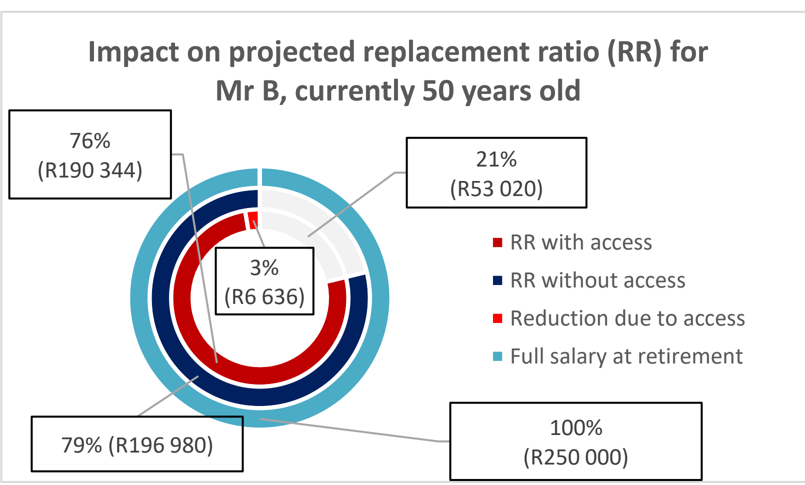
There is currently no indication of how any of the above options will be treated for tax purposes. If Government decides that the cash withdrawal or deduction must be treated as tax-free benefits, the ITA must be amended. If the pension-backed *lockdown* loan is treated in the same manner as the current pension-backed loans, the guarantee provided by the fund will not be taxable at the stage of granting the loan but the amount not yet repaid to the fund in the event of any exit from the fund will be taxable according to the exit event.

What will the impact of early access to retirement savings be?

Early access to retirement savings could potentially result in the postponement of financial hardship until the member retires. If a portion of the member's current retirement savings is accessed , it will reduce the member's income replacement ratio at retirement. For illustration purposes, the graphs below show the impact of access to retirement savings on the replacement ratios of two members earning the same salary but aged 30 and 50 respectively. Both members earn an annual salary of R250 000 and opt to withdraw an amount equal to three months' income, i.e. R62 500, from their retirement savings to enable them to replace lost income during the lockdown.



At age 30, Mr A has accumulated retirement savings of R195 761. From this, he withdraws R62 500 as financial relief. Mr A continues to contribute 14% to his savings until he retires at age 65. In today's money terms, Mr A was on track to earn an annual pension of R200 940. However, due to the withdrawal for financial relief, his expected pension reduces to R186 408 (7% less). The capital of R62 500 taken results in an annual reduction of R14 532 in expected pension by the time Mr A reaches age 65



At age 50, Mr B has accumulated retirement savings of R1 456 270. From this, he withdraws R62 500 as financial relief. Mr B continues to contribute 14% to his savings until he retires at age 65. In today's money terms, Mr B was on track to earn an annual pension of R196 980. However, due to the withdrawal for financial relief, his expected pension reduces to R190 344.

The capital of R62 500 taken results in an annual reduction of R6 636 in expected pension by the time Mr B reaches age 65.

These examples indicate that a reduction of retirement savings will have a negative impact on retirement outcomes. The examples further highlight that the impact will be greater for younger members due to the loss of future compound interest in addition to the capital reduction. If the reduction amount is large enough, it could result in inadequate retirement outcomes for the member.

We are keeping a close eye on any developments in this regard and will keep you updated on any progress made. For more information, please talk to your Momentum Consultants and Actuaries Consultant or contact us at mca@momentum.co.za.

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