BUSINESS & INDUSTRY VIEWS

Two-pot: Stay invested for a better retirement

Minimising early withdrawals is key to safeguarding your future financial well-being

By RAEL BLOOM

THE QUICK TAKE			
	The introduction of the two-pot system has seen an initial surge in withdrawals by retirement fund members	We expect this trend to taper off, allowing the system to fulfill its intended purpose of enhancing retirement outcomes	With over 30 years of expertise in managing retirement assets, our experience has shown that long-term financial success is built on the foundation of staying invested

Rael is a product development actuary with 20 years of investment industry experience.

IT'S BEEN JUST over a month since the South African retirement fund system underwent its most significant transformation: the introduction of the two-pot system. After years of regulatory reforms, this change has finally brought compulsory preservation over the line – an essential step toward improving retirement outcomes for millions of South Africans.

In addition to compulsory preservation, the two-pot system also allows members to access a portion of their savings for emergencies. The initial wave of withdrawals has exceeded expectations. Within the first 10 days of the system going live in September, SARS received nearly 160 000 tax directive applications for savings pot withdrawals, amounting to R4.1 billion. The country's largest administrator processed more claims in the first week than in the prior six months combined.

While the reasons for these withdrawals will vary from person to person – ranging from genuine emergencies to non-essential spending – it's crucial to emphasise the long-term value of preserving savings. It's also a pivotal opportunity for funds to actively communicate the importance of disciplined saving to their members, ensuring they remain focused on securing a stable and prosperous retirement.

AN OPPORTUNITY FOR DEEPER ENGAGEMENT

While the initial focus has been on managing the influx of claims and ensuring operational readiness, this surge in withdrawals is expected to stabilise. We anticipate that once the dust settles, the two-pot system should function as intended – offering members the flexibility to access a portion of their savings in an emergency while preserving the majority of their savings until retirement. The real value of the system – and the financial security it can provide – depends on how well members understand the long-term consequences of early withdrawals.

This shift presents a unique opportunity for the retirement industry to engage with members more meaningfully than ever before. Historically, member interactions with their retirement funds were infrequent, often limited to major life events like job changes or nearing retirement. Now, with more regular transactional touchpoints, funds have the opportunity to continuously educate members on the hidden costs of early withdrawals and the significant benefits of staying invested for the long term.

THE HIDDEN COST OF EARLY WITHDRAWALS

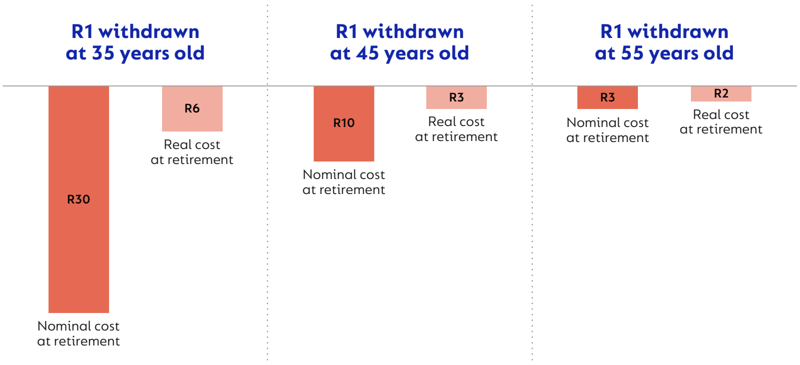
While the two-pot system offers flexibility for accessing funds during emergencies, early withdrawals come with significant long-term financial consequences that could drastically reduce a member's standard of living in retirement.

The immediate consequence is that withdrawals from the savings pot are taxed at the member's marginal tax rate, meaning a portion of each withdrawal is lost to taxation. Members who wait until retirement to withdraw benefit from preferential lump sum tax tables. By withdrawing early, they effectively forfeit this valuable tax advantage.

More importantly, members disrupt the powerful effects of long-term compounding when they withdraw early. Compounding enables retirement savings to grow exponentially over time, as returns generate further returns. For instance, as we highlighted earlier this year, for every R1 withdrawn from a retirement fund 30 years before retirement, the future value of a member's savings is reduced by around R6 in real terms, due to the opportunity cost of foregoing compounded growth. Even over shorter periods, the impact is still significant – withdrawals made just 10 years before retirement could result in an opportunity cost of R2 (in real terms) for every R1 withdrawn. This serves as a powerful reminder that early withdrawals not only deplete the current balance but can ultimately jeopardise long-term financial security.

Figure 1

THE COST OF BORROWING FROM YOUR FUTURE SELF



Assumes a retirement age of 65 and a balanced fund return of 12% per annum and inflation of 6% per annum.
Source: Coronation

THE POWER OF STAYING INVESTED

One of the greatest advantages of the two-pot system is that it offers flexibility without the immediate pressure to make withdrawals. The savings pot remains available indefinitely, allowing members to keep their funds invested and continue benefiting from growth over time. This ensures that members can access their savings only when truly necessary, without sacrificing potential long-term returns. Those members who are able to keep their savings invested until retirement will enjoy a substantially better standard of living in retirement.

With over 30 years of managing retirement fund assets, we have experienced firsthand the immense value of long-term compounding — and our message is simple: **stay invested where possible.**

For example, our flagship multi-asset Global Houseview strategy has delivered real returns of 9.2% per annum since its inception in 1993. To put this into perspective, R100 000 invested at the strategy's launch in October 1993 would have grown to R7,6 million today[1] . This showcases the significant growth potential of staying invested. We have successfully navigated a wide range of market conditions, demonstrating that members can achieve long-term growth regardless of short-term fluctuations.

The core objective of a retirement fund is to secure a dignified retirement for its members. While the two-pot system provides flexibility for those facing genuine financial hardship, this goal remains paramount. Staying invested in a well-managed fund is the most reliable way to achieve long-term financial security.

THE PATH TO A SECURE RETIREMENT

While the initial attention has rightly been on managing claims and helping members understand the mechanics of the two-pot system, it's crucial not to lose sight of the broader goal. This system is designed to provide members with long-term security and ensure a dignified retirement. The shift to more frequent interactions offers funds the unique opportunity to consistently reinforce this overarching objective.

The compulsory preservation of two-thirds of retirement savings is a major step forward and will greatly improve retirement outcomes for most members. However, it's vital to emphasise that by avoiding or limiting early withdrawals, members can substantially enhance their future standard of living. Keeping funds invested allows members to fully harness the benefits of compound growth alongside tax advantages over the long term.

The message is clear: stay invested, where possible, and let your savings grow for a more secure retirement. +

[1] As at 31 August 2024

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South African Readers

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