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Changes to provident and provident preservation funds: What will they mean for members?

The latest Taxation Laws Amendment Bill includes changes to the laws that govern provident and provident preservation funds that will come into effect from 1 March 2021. The changes are the final step in the National Treasury's process of aligning (also referred to as harmonising) the benefits and rules of provident and provident preservation funds with those of pension and pension preservation funds. Shaun Duddy discusses the changes and what they will mean for members of provident and provident preservation funds.

As things stand, the difference between provident funds and pension funds is that provident fund members can take up to 100% of their provident fund benefits in cash at retirement, if required, while pension fund members are required to use at least two-thirds of their benefits to purchase a product that will provide them with an income in retirement, unless their benefits in a pension fund are less than R247 500. This difference also exists between provident preservation funds and pension preservation funds. Previously, there was also a difference in the tax deductibility of contributions to provident and pension funds but, to start the harmonisation process, the tax deductibility of contributions was aligned in 2016. To complete the harmonisation process, benefits from contributions made to provident funds from 1 March 2021 onwards will be subject to the same rules at retirement as pension fund benefits, except where provident fund members are 55 or older on 1 March 2021 and remain members of the same provident fund(s).

What will the changes mean for existing members?

For members of provident and provident preservation funds on 1 March 2021, all benefits in these funds as at 28 February 2021, plus any future growth on these benefits, will not be impacted by the changes. These benefits will be given "vested rights", meaning that members will still be able to take up to 100% of these "vested benefits" in cash at retirement, if required. These vested rights will continue to apply even if members transfer these vested benefits to other retirement funds before they retire, including if they transfer these benefits to pension, pension preservation or retirement annuity funds. The changes will also have no impact on the access that provident and provident preservation fund members have to their benefits before retirement.

In addition to the vested rights on existing benefits as at 28 February 2021, if existing provident fund members are 55 or older on 1 March 2021, and remain members of the same provident fund(s), they will also receive vested rights on their benefits from new contributions made to these funds from 1 March 2021 onwards.

For existing members younger than 55 on 1 March 2021, the changes will therefore only impact benefits from new contributions made from 1 March 2021 onwards. For existing members 55 or older on 1 March 2021, the changes will only impact new contributions made to provident funds joined for the first time after 1 March 2021, as these contributions will not receive vested rights. Members will be required to use at least two-thirds of these "unvested benefits" to purchase a product that will provide them with an income in retirement, unless their unvested benefits in a retirement fund are less than R247 500, or whatever this amount may be in future as stipulated in the retirement fund laws.

What will the changes mean for new provident fund members?

Members of all ages who start contributing to provident funds for the first time after 1 March 2021, will immediately be subject to the new laws, i.e. all of their benefits will be unvested. Both at and before retirement, these new members' benefits will experience the same benefits and rules as if they were in a pension fund.

Can members lose their vested rights?

As mentioned, vested rights will be given to existing provident and provident preservation fund members on 1 March 2021 and these vested rights will remain intact until retirement, even if the vested benefits are transferred to a different retirement fund. If, however, these members access benefits before retirement, or benefits are deducted from their retirement funds before retirement, their vested benefits will be reduced as part of this.

In summary, provident and provident preservation funds will be "equivalent" to pension and pension preservation funds from 1 March 2021, with the important exception of vested benefits that will not experience any changes. This "equivalence" will also mean that any tax consequences of transferring pension and pension preservation fund benefits to provident and provident preservation funds will be removed. Lastly, as a reminder, the treatment of retirement annuity fund benefits at retirement is already equivalent to the treatment of pension and pension preservation fund benefits at retirement. Therefore, from 1 March 2021 all of these retirement funds will be aligned.

How will this work at retirement?

Let's consider a member who is younger than 55 on 1 March 2021 and retires from their retirement annuity fund after 2021 with R3m. R2m is vested benefits, from benefits that were in a provident fund on 28 February 2021 and later transferred, and R1m is unvested benefits, R250 000 from contributions to the provident fund from 1 March 2021 onwards and later transferred and R750 000 from contributions to the retirement annuity fund. Of the R1m unvested benefits, the member will have to use at least two-thirds to purchase a product that will provide them with an income in retirement[1], while they will still be able to take up to 100% of the R2m vested benefits in cash, if required.

If this member was 55 or older on 1 March 2021, their vested benefits would be R2.25m, R2m from benefits that were in the provident fund on 28 February 2021 and R250 000 from contributions to the provident fund from 1 March 2021 onwards before transferring. In this case, the member would have to use at least two-thirds of their R750 000 unvested benefits to purchase a product that will provide them with an income in retirement[1], while they would be able to take up to 100% of their R2.25m vested benefits in cash, if required.

Enhancing preservation

The harmonisation of provident and provident preservation funds with pension and pension preservation funds is part of the National Treasury's broader retirement reform initiatives, and aims to enhance the preservation of retirement fund benefits so that retirement fund members are able to provide a better income for themselves in retirement, which we believe is a good thing. The changes will impact the members of our Allan Gray Umbrella Provident Fund and Allan Gray Provident Preservation Fund. We are taking the necessary steps to effect the changes, especially in relation to allocating vested rights to these members, administering the vested benefits over time and reporting on the vested benefits to members. We will communicate further in the new year.

[1] The assumption is that de minimis, which is currently R247 500 but could be increased in future, is still below the R1m or R750 000 at the point of retirement.
Commentary contributed by Shaun Duddy, Product development manager, Allan Gray