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Early access to retirement savings in South Africa is a risk: here's why

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The COVID-19 pandemic has put a financial strain on businesses, households and individuals. It's leading more older adults to retire early, according to recent research. This means retirees could be making increased claims on social security benefits.

The pandemic pressures are one reason that South Africa's National Treasury announced in August 2021 that it planned to overhaul the retirement rules. With the rise in costs of living and income insecurity, many people simply can't afford to wait until retirement to access their pensions. It is expected that the overhaul will come into effect in 2022.

Currently, retirement fund members can only access their pre-retirement benefits upon resignation or retrenchment. Even then, a steep level of tax is imposed on cashing out pensions to dissuade members from accessing these funds prematurely. This system has been in place since The Pension Funds Act of 1956. Members that resign or are retrenched are encouraged to preserve their pensions for retirement, as previous research found that pensions are the only form of long-term savings for many South Africans in formal employment. The situation is more dire for the unemployed and those in informal employment, who are estimated to make up two-thirds of all South Africans.

The treasury's decision may have positive short-term outcomes where individuals can use their pensions to meet immediate and urgent financial needs. But its long-term implications are a cause for concern, or they should be. My research suggests that most individuals are unlikely to understand these implications clearly and are therefore at risk of making poor financial decisions for the long-term. Only 6% of South Africans are estimated to be financially independent at retirement.

Financial literacy

For many people in South Africa, their family property and retirement savings are the biggest part of their wealth. If they start tapping into their retirement savings and investments early, their wealth won't have time to grow and their nest egg might be used up sooner than planned.

It starts with savings. And research consistently demonstrates that people are more likely to save if they are financially literate. They have to understand the advantages of long-term savings. Professional financial advice is instrumental in fostering long-term savings and investments, yet less than 20% of South Africans have financial advisers.

The ability to save for retirement is complicated in South Africa by the fact that differences in employment, income and financial literacy are still racialised. The national treasury's proposal may widen these differences.

While past studies have explored the general financial literacy of South Africans, little is known about their retirement literacy.

I decided to fill in some of this gap by conducting a study of 125 individuals who hadn't yet retired. The study was done in the Eastern Cape province of South Africa, where most of the respondents indicated that they are black South Africans, with a bachelor's degree as their highest level of education. The research sought to answer two questions: 1) To what extent do individuals perceive themselves to be retirement literate? 2) How does the perceived retirement literacy of individuals compare to their actual retirement literacy?

I found a clear discrepancy between how much people thought they knew and what they actually knew about finance for retirement. With the financial pressures caused by the pandemic, and conversations around early access to retirement funds, the need to bridge this divide is apparent.

Good intentions

My research comprised two parts. In the first, I administered a questionnaire about what respondents thought of their own retirement knowledge, retirement planning skills, intentions to actively plan for retirement and the activities undertaken to plan for retirement.

The questionnaire revealed that most people who participated in the research (65%) intended to plan for their retirement by making contributions towards a pension fund and planned to seek professional financial advice for their retirement. The sample also agreed (43%) that they understood how retirement funds operate. More than half of the respondents (53%) stated that they were comfortable with the concepts relating to retirement, they could apply their knowledge to improve their financial welfare and were preparing for a financially secure retirement.

In the second part of the study, I investigated the actual retirement literacy of individuals through a multiple-choice test. The main areas of the test covered: general financial knowledge; retirement-related investments and advanced retirement knowledge. One question weighed their understanding of inflation and its impact on savings. Another gauged their knowledge on asset allocations in retirement funds. The knowledge around tax implications on retirement benefits was also assessed.

Overall, 59% of the sample failed the retirement literacy test. While most people (75%) could correctly answer the general finance-related questions, less than half of the respondents (47%) could answer the retirement-related finance questions. When more advanced retirement-related concepts were presented to the respondents, only 10% gave the correct answers.

In particular, the respondents lacked knowledge on how shares, in the long-term, outperform other types of financial securities and the significance of preservation funds. This finding corroborates reports on how many South Africans don't save their retirement provisions received from their pension when changing jobs or employers.

Perceived and actual knowledge

Now that many people are under financial pressure and may soon be allowed to spend a portion of their retirement savings, it's important that they should understand the options and risks.

While the services of a professional financial planner can assist in managing retirement plans and savings, the extent to which money management is taught at home must also be considered.

A act of saving is a cultural value, one that is passed on from one generation to another. Instilling this value from a young age can change the way finances are managed from young adulthood into older age. This would have the benefit of reducing dependence on family and government grants at retirement.

Overcoming the taboo around money talk in families and communities assists the development of positive financial attitudes, demystifies financial management and promotes financial well-being.