Atleha-edu

Speaking life into investment decisions www.atleha-edu.org

SHORT ARTICLE SERIES

Our purpose at Atleha is to help ordinary South Africans save and invest for a better tomorrow.

We do this through Financial Sector Code (FSC) compliant - awareness and interactive education programmes focused on retirement fund trustee, management committee member; and fund member awareness and education initiatives, such as this short article.

We would like to thank Old Mutual On the Money for funding this short article series.

UNDERSTANDING THE DIFFERENCES BETWEEN DB AND DC FUNDS

Dear HR Manager:
I have the option of choosing between a defined benefit or a defined contribution pension fund with my future employer. Please can you explain the difference?

OLD MUTUAL ON THE MONEY

Dear Future Employee:

- **A Defined Benefit fund** provides a guaranteed pension benefit on retirement which is calculated based on your final average salary multiplied by the years of your fund membership as an employee. The rate at which you contribute to the fund is usually fixed as a percentage of your remuneration. Your employer's rate of contribution towards your retirement benefit is usually calculated by the fund's valuator who works out the rate at which the employer will need to contribute to the fund to enable the fund to pay you the guaranteed – or defined pension benefit – upon your retirement.

  Important to note: In a Defined Benefit fund, your employer carries the risk of the fund having to guarantee your pension due to you after retirement.

- **A Defined Contribution fund** provides you with a pension benefit on retirement which is calculated based on the accumulated contributions made to the fund by you as the employee (and/or, where applicable, any contributions made by your employer). The returns earned on the investment of those contributions, less deductions of the costs of running the fund and providing for death and disability benefits, are added to the pension benefit. The rates at which you and your employer contribute to the fund are fixed or defined as a percentage of your remuneration.

  In a Defined Contribution fund, the value of your pension due to you is not guaranteed, but is instead based on the contributions you and your employer have made towards your retirement fund's investments, combined with the fund's investment performance. This means that you as the member – and not your employer - carries the risks and rewards of your final pension amount available to you at retirement.

SUMMARY OF THE KEY FEATURES OF DEFINED BENEFIT (DB) AND DEFINED CONTRIBUTION (DC) FUNDS

	Defined Benefit	Defined Contribution
The member contributes	A fixed percentage of salary (normally between 5% and 7.5%)	A fixed percentage of salary (normally between 5% and 7.5%) but they may often make additional voluntary contributions
The company contributes	The amount necessary to provide for the guaranteed pension benefit, as calculated by the fund's actuary from time to time	A fixed percentage of the employee's salary
Retirement benefit	A fixed benefit, as specified in the fund rules (according to a set formula)	A pension benefit based on all the contributions made, plus the net investment return, less the cost of risk benefits and administration
Determination of benefit	Formula based upon: • Final salary or final average salary • Number of years as a member of the fund	Member plus employer's total contributions, plus net investment returns less costs; the regular pension amount is determined by the annuity pension purchased by the member on retirement
Other risk benefits	Usually also based on formulas and risk, either carried by the retirement fund or reinsured with an insurer	Usually a percentage or multiple of salary and almost always reinsured with an insurer
Administration requirement	Administration intensive, especially if none of the benefits is insured or outsourced	Less complex administration, unless members are given the opportunity to switch investment portfolios on a frequent basis
Risk of investment performance	Carried mainly by the employer	Carried by the member / employee

Do you have a question that you would like us to address in a subsequent article?
If so, please send your questions or suggestions for article topics by email to:
info@atleha-edu.org