Engineering Industries Pension Fund

Conversion to a Defined Contribution Fund

Index

Engineering Industries Pension Fund ("the EIPF")

(12/8/5040)

Conversion from a defined benefit to a defined contribution basis with effect from 1 April 2012

Information Guide to Members

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1. Introduction

The Engineering Industries Pension Fund (hereafter referred to as "the EIPF") is a defined benefit pension fund.

The Trustees decided to convert the active member section of the EIPF from a defined benefit to a defined contribution dispensation with effect from 1 April 2012, in order to ensure the long term financial sustainability of the EIPF.

The conversion will have no impact on the current pensioners of the EIPF. Pensioners will continue to receive their pensions and future pension increases from the EIPF.

The purpose of this document is to give the active members of the EIPF more information regarding the conversion from a defined benefit to a defined contribution dispensation.

2. Rationale for conversion to defined contribution principles

The Trustees decided to convert the EIPF from defined benefit to defined contribution principles for the following reasons:

- The future contribution rates to the EIPF are likely to increase from 13,2% to 32,0% over time to sustain the current defined benefits.
- The Rules of the EIPF do not provide for these additional costs to be paid by the employer.
- Any contribution increases would need to be jointly funded or benefits would need to be reduced.
- The distribution of surplus in terms of the Pension Funds Act as at 1 April 2008, removes the surplus which could otherwise have been used to finance contribution requirements.

- The Registrar has limited the amount that can be set aside in a Contribution Reserve to finance future contributions.

3. Basis of conversion to defined contribution principles

The Trustees therefore took the following important decisions to safeguard members' interests and promote conversion by active members from defined benefit to defined contribution principles:

- That the current level of contributions will increase to 18%. Over time, the actual contributions will be increased to 7,5% by members and 10,5% by employers. To facilitate the required increase in contribution rates over a phased period, a special Contribution Increase Program Reserve Account (or "CIPRA") was established to subsidize the difference between 18% and the current contribution rates. The CIPRA was funded from a portion of the surplus, which existed at the surplus apportionment date.

- That converting members will receive an additional 45% conversion enhancement to each individual member' basic actuarial reserve value at the conversion date (1 April 2012). This enhancement was secured to ensure that converting members are reasonably protected against the risk in a defined contribution environment. A special conversion reserve account was established as part of the surplus apportionment exercise to fund this conversion enhancement.

4. Defined benefit versus defined contribution principles

	Defined benefit	Defined contribution
a)	A **defined benefit fund** with active members and pensioners.	A **defined contribution fund** with active members and pensioners. _Note_: *The change in the benefit structure will have no impact on the benefits paid to current pensioners.*
b)	**Retirement benefits** are defined in the Rules as a function of years of service and final salary. The expected pension payable at retirement is therefore relatively easy to calculate.	**Retirement benefits** are dependent on the level of the future contributions for retirement and future investment returns. The expected amount available at retirement is therefore not known in advance. Members will however receive annual benefit statements indicating their accumulated fund benefits.
c)	**Member contributions** are a fixed percentage of pensionable salary.	**Member contributions** are a fixed percentage of pensionable salary.

	Defined benefit	Defined contribution
d)	**Employer contributions** are also a fixed percentage of pensionable salary. _Note_: *This poses a threat to the financial sustainability in the long term since there is no obligation on the employer to fund any deficit that may emerge in the EIPF. This may mean that benefits may have to be decreased to ensure the financial soundness of the EIPF.*	**Employer contributions** are also a fixed percentage of pensionable salary. The net employer contributions, after deduction of the costs of death and disability benefits as well as administration and management expenses, are allocated per member and forms part of all future benefits payable from the EIPF.
e)	An Employer normally carries the **investment risk** in a defined benefit arrangement. Since the Employer contributions are however fixed in terms of the Rules, there is no obligation to carry any investment risk. Such investment risk is therefore borne by the EIPF and eventually the members in that benefits may have to be adjusted to ensure the financial soundness of the EIPF. Good investment returns are usually held as a solvency buffer to protect the EIPF. However the scope to hold a solvency buffer is now restricted in terms of the Pension Funds Act, leaving little additional security for members.	The member carries the **investment risk**. If returns are good, the benefit will be better and if returns are poor then benefits will be lower.

5. Features of the new defined contribution fund

Structure:

The EIPF will consist of two sections, namely an active member section and a pensioner section. The two sub-sections will be managed separately to protect the two groups of stakeholders in the EIPF.

Type of Fund:

The EIPF is registered as a **pension fund**.

Member contributions are deductible for tax purposes.

A maximum one-third of the retirement benefits may be taken in cash and the balance must be applied to purchase a pension from either a registered insurer or from the EIPF itself.

Management:

The EIPF will continue to be managed by a Board of Trustees with representation from members (via the Unions) and the Employers.

6. How will my retirement benefits be calculated?

Under the current EIPF structure your retirement benefit is calculated with **defined benefit principles**, namely:

- The retirement benefit is determined according to a formula as defined in the Rules: A pension of 2% of final salary for each year of pensionable service.
- Final salary is defined as the average salary over three years before retirement.

Under the new EIPF structure your retirement benefits will be calculated with **defined contribution principles**, namely:

- Your existing benefit in the defined benefit arrangement will be determined as at the conversion date and this will represent your starting value in your individual account in the new Fund. [Refer to Section 7 below for more detail in this regard.]
- Your own contributions to the new fund will be allocated to your individual account.
- Contributions by the employer will be added to your individual account, after deduction of the costs of death and disability benefits as well as administration.
- The member and net employer contributions referred to above will be invested on your behalf and your individual account will be credited with the net investment return earned on your account.
- The total in your individual account is also referred to as your **Fund Credit**.

7. What will happen with my accrued retirement benefits in the existing defined benefit arrangement?

The **total starting value of your fund credit** under the defined contribution dispensation will therefore be calculated as follows:

Actuarial Reserve Value, subject to minimum of MIR as at 1 April 2012 (See 7.1)	+	30% surplus in terms of Section 15B as at 1 April 2008 (if any) plus returns (See 7.2)	+	45% enhancement upon conversion as at 1 April 2012 (See 7.3)

7.1 Actuarial reserve value

The actuarial reserve is the current value of your expected fund benefits that have accrued in respect of past service (the service from entry to the EIPF till the conversion date). The actuarial reserve is determined based on best estimate assumptions used in the statutory actuarial valuation of the EIPF, with respect to factors like investment returns, salary increases and the probability of withdrawal, death and retirement. This value is calculated by the Fund Actuary.

The **actuarial reserve as at the conversion date will form the basis for the calculation** of your starting value in your individual account, in the new defined contribution dispensation.

The Pension Funds Act provides for the payment of minimum benefits to all members who exit the EIPF prior to retirement or who convert from a defined benefit to a defined contribution dispensation.

In the case of a defined benefit fund, the Minimum Individual Reserve (also referred to as "MIR") is defined as the greater of:

- The cash value of the member's deferred pension at retirement (based on the member's pensionable service and salary as at the calculation date and discounted on a prescribed basis set out by the Pension Funds Act); and
- The net member and employer contributions plus fund interest from date of payment to the fund.

The member's starting value (that is, the actuarial reserve referred to above) will therefore be subject to a minimum of the member's calculated MIR.

7.2 Surplus apportionment in terms of Section 15B

Active members who were also active members at the surplus apportionment date will be credited with the accumulated value of their surplus apportionment amount after approval by the Registrar of the EIPF's surplus apportionment scheme.

The surplus apportionment amount is equal to 30% of an active member's actuarial reserve value at the surplus apportionment date (that is, 1 April 2008), subject to a minimum of R 1 000 per stakeholder.

Note: *These monies will be held in a separate surplus individual account on your behalf, and will be added to your individual account at the conversion date or after the approval of the surplus apportionment scheme (if later)*.

A separate **surplus information booklet** was distributed in this regard. The surplus information booklet contains details on who qualifies for a share in the surplus of the EIPF at the surplus apportionment date.

7.3 Additional enhancement upon conversion

At the conversion date an additional amount of 45% of your actuarial reserve as calculated in Section 7.1 above will be added to your starting value in the new defined contribution dispensation.

8. Comparison of benefits between the existing defined benefit and new defined contribution arrangement

Defined benefit	Defined contribution
Normal Retirement	
• The normal retirement age is 65.	• The retirement age for all members is 65.
• The benefit is defined as 2% of final salary for each year of pensionable service. Final salary is defined as the average annual salary over the last three years before retirement.	• The retirement benefit is a pension that can be secured with the total fund credit in the EIPF.
• Up to one third of the pension can be taken in cash.	• Up to one third of the total fund credit can be taken in cash and the balance must be applied towards a pension.
• The balance of the pension is paid as a monthly pension income from the EIPF.	• Members may purchase a pension from the EIPF on retirement. They will then become pensioners in the EIPF.
	• Alternatively, members may also choose to purchase a pension from any insurer outside the EIPF. In such instances, their membership will terminate at retirement.
Early retirement	
• Within 10 years of the normal retirement date.	• Within 10 years of the normal retirement date.
• The calculated pension is reduced by 0.25% for each month the member retires before the normal retirement date.	• The accumulated fund credit becomes available. No adjustment is made to such benefit.
Late retirement	
• The normal benefit at normal retirement age is increased at a rate as agreed between the EIPF and the Actuary.	• The fund credit at the normal retirement date is increased by the net investment returns till the actual date of retirement.
• Contributions continue after the normal date of retirement.	• Contributions continue after the normal retirement age. Any contributions will be applied for the benefit of the member.

Defined benefit	Defined contribution
Withdrawal benefits • The cash benefit is equal to the member's optional contributions (if any) accumulated at fund interest, plus the member's compulsory contributions accumulated at fund interest, plus the net employer contributions accumulated at fund interest. • This benefit is subject to the minimum of the prescribed Minimum Individual Reserve or "MIR" (refer to section 7.1 above for an explanation of the MIR).	• The withdrawal benefit is equal to the full accumulated fund credit.
Death benefits (before retirement) • For a member not leaving a spouse, the lump sum at death is the greater of 2 times the annual pensionable salary and the member's cash withdrawal benefit. • For a member leaving a spouse the benefit is a lump sum as above plus a spouse pension of 40% of the expected pension at retirement but with the salary at date of death. • No children pensions are payable.	• The death benefit is equal to a lump sum as a multiple of member's annual pensionable salary. The multiple depends on age with the multiple being 5 at younger ages and decreasing to 0,5 at older ages. [Refer to Annexure 1 for a summary of the table of lump sum death benefits.] • In addition, the member's fund credit is also payable. • **The overall death benefit is subject to a minimum of 2 times the annual pensionable salary.** • No additional spouses or children pensions are payable. • This will remove the discrimination between married and unmarried that existed in the existing defined benefit dispensation. [Currently married members enjoy higher benefits than single members.] • **Important**: The beneficiaries will have a choice of taking the total death benefit as a lump sum in cash or purchasing a pension income with the lump sum benefit from either the EIPF or from any registered insurer.

Defined benefit	Defined contribution
Death benefits (after retirement) • The pension at retirement is guaranteed for a period of 5 years. After the expiry of the guaranteed period, 60% of the pension before commutation is payable to the qualifying spouse (if any).	• This will depend on the type of pension that the member elected at retirement. • For example: If the member elected a single life pension the pension will cease at the latest of the expiry of any guaranteed period or the date of death, if a joint life pension was elected it may be similar to the benefit in the existing defined benefit dispensation.
Permanent Disability benefits • An income of 75% of the member's pensionable salary will be paid from the separate disability scheme (PDS). A lower benefit is payable if the member joined the EIPF for the first time after age 55. • The member remains a member of the EIPF. The member contributions are deducted from the income and paid to the EIPF. The Employer contributions are also paid from the PDS to the EIPF to maintain the benefits in the EIPF. • The income is payable as long as the member is not able to work till retirement age and at retirement age the member will receive the normal retirement benefits in terms of the Rules of the EIPF.	• The same disability benefits are payable. • The eventual retirement benefits are determined on a defined contribution basis.

9. How will monies be invested for converting members in the new defined contribution arrangement?

The investment portfolios will initially be the same as that under the current arrangement. The Board of Trustees has a specific Investment Sub-committee who meets on a regular basis to monitor the investments of the EIPF. Both the members and Employers are represented on the Investment Sub-committee.

The aim is to maximize the expected investment returns on the assets but within acceptable levels of risk.

After the conversion, the actual investment returns earned on the assets of the active members' section of the EIPF will be credited to your individual account. Investment returns may be positive or negative from month to month so your individual account balance will fluctuate from month to month.

The EIPF assets have achieved an average return of 6,2% above inflation over the 10 years ending 31 March 2010.

Note: Past performance is not a guarantee for future performance.

The Trustees **aim** to achieve an investment return of 5% more than inflation, over the long term. For example if inflation is 5% per annum, the goal of the Trustees is to achieve 10% per annum.

Please note that the pensioners' assets may be invested and managed separately.

10. Advantages of the existing defined benefit and new defined contribution arrangements

Defined benefit	Defined contribution
• Your retirement benefits are linked to your salary at retirement and this gives some protection against inflation. • Your retirement benefits are defined in the Rules and investment returns will not impact on your benefits. • Your benefit at retirement can be determined relatively easy (as a percentage of your salary at retirement).	• Your withdrawal and retirement benefits will be fair since it will comprise the total in your account at the date of withdrawal and this will include the total net Employer contributions as well. • You will gain directly from good investment returns since your fund benefits will be accumulated at the rate of return earned on the assets. • There will be no cross subsidies between members since your own contributions as well as the net Employer contribution on behalf of you, will be allocated to your own account.

11. Disadvantages of the existing defined benefit and new defined contribution arrangements

Defined benefit	Defined contribution
• Your benefits are defined in the Rules and you cannot influence that. • Good investment returns will have no effect your retirement benefits. • Continued poor investment returns may lead to a reduction of the future accrual of benefits in order to maintain the financial soundness of the EIPF. • There are cross subsidies between young and old members, married and unmarried as well as between high and low earners.	• Protection against inflation before retirement will to a large extent depend on the expected investment returns on the assets. • The member carries the investment risk. Good investment returns will translate to better retirement benefits but poor investment returns will mean lower retirement benefits. • The benefit at retirement is not easily calculated since it depends on future contributions as well as expected investment returns.

The Trustees decided to give an enhancement of 45% to each of the converting member's actuarial reserve values at the actual conversion date to compensate members for these disadvantages. In other conversion exercises, enhancements generally ranged from 5% to 30% with an average of 25%. Hence, members have been given a very lucrative enhancement. The Fund Actuary is satisfied that the enhancement is fair and reasonable in the overall context of the surplus apportionment exercise and the additional risk which members face.

12. How will I know that my existing benefits have been transferred?

Once the Registrar approved the conversion, each member's benefit will be determined as at the date of conversion. Each member will receive a transfer statement which will show the benefit as at the conversion date. Such statement will serve as proof of your starting value in the new defined contribution arrangement of the EIPF.

13. What if I decide not to convert?

The Trustees have decided to convert all members to defined contribution principles, as this is in their best interests, provided that there are no significant objections.

14. In summary

The Trustees are satisfied that the proposed conversion terms are in the best long term interest of the EIPF and its members and have unanimously agreed to the conversion.

Any queries relating to or objections against the conversion must be directed **in writing and all objections must be properly motivated** to the Board of Trustees within 12 weeks of the distribution of the member communication, i.e. **before 29 July 2011.**

The address details are as follows: **The Conversion Committee; Engineering Industries Pension Fund; Private Bag X11; MARSHALLTOWN; 2107**

The information can also be e-mailed to **conversion@mibfa.co.za** or faxed to **(011) 688 3094**. Queries will be dealt with as soon as possible.

The Principal Officer
Engineering Industries Pension Fund **Approved on 15 March 2011.**

Annexure 1 – Lump sum death benefits

The following death benefits will be payable upon the death of an active contributing member:

Age in full years at death	Lump sum death benefit			Minimum death benefit
30 years and younger	5,0	times salary	plus fund credit	2 times salary[1]
31 to 33	4,5	times salary	plus fund credit	2 times salary[1]
34 to 37	4,0	times salary	plus fund credit	2 times salary[1]
38 to 41	3,5	times salary	plus fund credit	2 times salary[1]
42 to 44	3,0	times salary	plus fund credit	2 times salary[1]
45 to 46	2,5	times salary	plus fund credit	2 times salary[1]
47 to 49	2,0	times salary	plus fund credit	2 times salary[1]
50 to 53	1,5	times salary	plus fund credit	2 times salary
54 to 60	1,0	times salary	plus fund credit	2 times salary
61 to 64	0,5	times salary	plus fund credit	2 times salary

The normal retirement age is 65. The death benefit in case of members who die in active service after the age of 65 years will be the fund credit.

Note: The term “salary” refers to your pensionable salary.

[1] The minimum will in practice only kick in for members age 50 years and older at their date of death.