ZIMBABWE ELECTRICITY SUPPLY AUTHORITY
STAFF PENSION FUND
"Retirement Security. Today and Tomorrow"

ZEIPF
ZIMBABWE ELECTRICITY INDUSTRY PENSION FUND
"Retirement Security. Today and Tomorrow"

How do Defined Benefit (DB) and Defined Contribution (DC) Funds operate?

In this session, we will look at the two main types of pension fund arrangements/plans; Defined Benefit (DB) and Defined Contribution (DC). This paper will look at the operational structure, characteristics, benefits, and drawbacks of the two types of pension plans.

Definitions

A pension arrangement is a retirement plan that requires a sponsor, usually the employer, to contribute funds towards a worker's exit benefit. The contributions made are invested on the employee's behalf, and the accumulated amount provides the retirement/exit benefit for the employee (member). The benefiting employee may be allowed to contribute a portion of their salary income towards the retirement benefit. Employee contributions may be voluntary or mandatory.

a. **Defined Benefit (DB)** – In a defined benefit arrangement, the retirement benefit for the member is based on a pre-determined formula, which is often based on the member's salary and years of service. The employee pays a fixed proportion of income towards retirement whereas the Employer meets balance on the cost of providing the promised benefit.

b. **Defined Contributions (DC)** – In a defined contribution arrangement, the retirement benefit is determined by the value of the accumulated contributions towards retirement. The benefit on exit is based on investment performance. The employer's liability to a defined contribution plan ceases when contributions towards retirement benefits are paid off.

The ZESA Staff Pension Fund was originally set up as a DB arrangement whereas the Zimbabwe Electricity Industry Pension Fund (ZEIPF) was originally set up as a DC arrangement.

ZESA Staff Pension Fund Benefit Calculation

The pre-determined formula for benefit calculation for ZESA Staff Pension Fund retirees is:

*Accrual Rate * Pensionable service * **Basic Final Salary***

Characteristics of DB and DC Pension Plans

The table below outlines the key characteristics of each pension arrangement:

Characteristic	Defined Benefit Plan	Defined Contribution Plan
Employee Contributions	Fixed proportion of income	Fixed proportion of income
Voluntary Contributions	May/May not be allowed, depending on the Rules	May/May not be allowed, depending on the Rules
Employer Contributions	Varies, depending on funding level	Fixed proportion of income
Expenses	Fully met by the Employer	Fully met by the Employer
Investment Risk	Risk and reward borne by the Employer	Risk and reward borne by the member
Operational Risk	Risk and reward borne by the Employer	Risk and reward borne by the member
Benefits on exit	Pre-determined formula	Accumulated contributions + Investment return

Advantages and Disadvantages of each pension plan

The benefits and drawbacks of each pension plan are outlined below;

	Advantages	Disadvantages
Defined Benefit Plan	**Benefits to Member** • Easy to understand, • Predictable benefit at retirement • No risk undertaking **Benefits to Employer** • Incentive for staff retention, • Benefit from good investment returns, • Employer retains ownership of residual surplus	**Disadvantage to members** • No benefit from high investment returns, • Low benefit pay-out if salary growth is limited • Not ideal in a high-inflation environment **Disadvantage to Employer** • Annual financial reporting of defined benefit obligation, • High risk undertaking (investment, operational and expense) • Unpredictable cost
	Advantages	**Disadvantages**
Defined Contribution Plan	**Benefit to Member** • Transparent,	**Disadvantage to members**

	• Members stands to benefit from positive investment performance, • Members entitled to full benefits on early resignation **Benefit to Employer** • Manageable and predictable cost	• Exposure to negative investment returns, • Unpredictable final pension **Disadvantage to Employer** • Supports a mobile workforce • Employer does not benefit from emerging surplus

Conclusion

Defined Contribution pension plans are becoming more popular as they offer favorable and manageable risk reward structures for employees and predictable cost for employers. Employees are better-off in a defined contribution pension plan if investment returns are higher than salary growth-rates.

Questions and comments

Join us for an interactive Zoom discussion on this topic with the Principal Officer on the 21st of July 2021. The session commences at 0900 hrs. on Zoom on link https://zoom.us/j/94911990121?pwd=aGRvcDRQYVIvSjh3SC9GOHJXSWhadz09
ID 949 1199 0121 Passcode UNcZ29.

We are gladly available to respond to any questions you may have on this matter. You may post your questions on the official WhatsApp group by clicking on this link https://chat.whatsapp.com/IGHAHRGqfp6272K7JZLqFV The WhatsApp platform will be open from 0900 hrs. on Wednesday 21 July 2021 to 0900 hrs. on Thursday, 22 July 2021.

We look forward to an insightful engagement!