# UNDERSTANDING YOUR PENSION

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## Contents

## Your pension scheme

What do the terms deposit interest rate and supplementary pension mean? And what happens to your pension contributions from the time they are paid to DIP until they are paid as pension benefits?

It may be difficult to fully comprehend the true nature of pension. A pension scheme must provide security in the everyday life, and in order to understand the information that you receive about your pension scheme in DIP, we have prepared this more technical description.

Though it is not possible to make a direct comparison of two pension offers if you do not know the precise assumptions about interest payment, life expectancy, disability etc., DIP wants to make the figures as transparent as possible.

Below description does not deal comprehensively with pension schemes subject to Regulations 1 and 2.

## From pension contribution to pension benefit

At the end of the day, the pension contributions must fulfill your wishes and needs to your life in retirement. The annual deposit statement shows how your savings develop.

The deposit statement, which is available on *Min pension*, includes, besides the value of payments at the beginning of the year (the amount already saved), contributions and possible single contributions paid during the year as well as added interest payment which is the deposit interest rate for the year determined by the board. Finally, the individual pension return tax (PAL-taxation), costs related to insurance cover and group life as well and administrative costs are deducted.

The deposit interest rate is the annual payment of interest to your deposit. The deposit interest rate is determined annually based on the pension fund’s financial situation. Members subject to the same regulations are always paid the same interest rate while there may be different interest payments on the different regulations. The different deposit interest rates reflect the different degrees of risk related to the different schemes’ pension commitments

**Deposit statement**

Value of payments at the beginning of the year
+ Paid contributions and single contributions
+ Interest payment
- PAL-tax
- Costs related to insurance cover
- Costs related to group life
- Administrative costs

= Value of payments at the end of the year

Members subject to Regulations 3 and 4 have schemes based on a basic interest rate up to 0.5 %, and the pensions are calculated according to a conditional basis. This results in a different solvency risk compared to the members subject to Regulations 1 and 2 who have pension schemes with a basic interest rate up to 4.5 %.

The current deposit interest rates appear from dip.dk

Costs related to insurance cover include the price of disability pension, possible children’s and/or spouse’s pension and pension life cover as well as exemption from paying contributions. The costs are calculated according to the technical basis and determined on basis of statistical and mathematical assumptions.

Costs related to the group life include both the group disability and group accident insurances as well as insurance in the event of certain critical illnesses. The current premium appears from dip.dk

The administrative costs cover the day-to-day business. The current administrative costs appear from dip.dk

The deposit value at the end of the year corresponds to the amount saved.

## Min pension

On *Min pension* you can keep track of the development of your savings. You can see your total contributions, your covers and possible pensions in payment (retired members cannot see their deposits).

## The pension commitment

DIP's main product is the life annuity while the annuity certain and retirement insurance are alternative savings products. In the following, the main emphasis is on the life annuity.

The pension commitment shows your cover in the event of death, disability etc. as well as expected payment on retirement. The pension commitment is calculated according to a technical basis determined by a number of assumptions about future interest rates, costs, disability and mortality risks as well as marriage and child frequencies everything under consideration to age and life expectancy.

The technical basis is determined by the board in consultation with the actuary in charge and is the pension fund's *set of rules* when the pension commitments and pension provisions are calculated. The technical basis is notified to the Danish Financial Supervisory Authority (the FSA).

**Is there a difference between men and women's pensions?**
The pension schemes in DIP are based on a unisex principle which means that men and women's life expectancy and disability risk are based on equal assumptions. Accordingly, men and women are treated equally.

**The technical basis**
From a regulatory point of view, the technical basis must be 'prudent' which means that the life expectancy must not be too low, the basic interest rate not too high etc.

Calculation of the pension commitment is based on three key assumptions:

- Interest payment.
- Costs.
- Biometric assumptions (disability, mortality etc.).

<u>Interest payment</u>
The assumption for calculation is the basic interest rate. On Regulations 1 and 2 it is up to 4.5 % while it is up to 0.5 % on Regulations 3 and 4.

<u>Costs</u>
The assumption for calculation is administrative costs of 5 %.

<u>Biometric assumptions (disability, mortality etc.)</u>
The assumption for calculation is statistical assumptions about disability, mortality etc. There are different assumptions applying to each set of regulations.

**The basic and supplementary pension**
Since the 'Choice of pension' in 2006, *the total pension* has been composed of a *basic pension* and a *supplementary pension*. The total pension is determined regularly according to realistic expectations about the future.

**The basic pension**
The basic pension is funded. This means that the pension provisions include an amount corresponding to the current value of the pension commitments. The basic pension is calculated according to the technical basis including the basic interest rate and a number of assumptions about e.g. mortality and disability.

On Regulations 3 and 4, the basic pension is calculated according to a conditional basis including a basic interest rate up to 0.5 %. For members admitted on 1 December 2017 or later, the basic interest rate will be 0 % which also applies for members who transfer from Regulations 3 to 4 from 1 December 2017. For members admitted before 1 December 2017, the basic interest rate is 0.5 %, however, contribution increases, single contributions and added bonus will have a basic interest rate of 9 % from 1 December 2017. The conditional basis implies that the basic pension may be reduced if the assumptions are changed permanently, or if current legislation is changed, cf. Regulations 3 article 27.2 and Regulations 4 article 16.2. The size of the basic pension appears from all pension calculations.

On Regulations 1 and 2, the basic interest rate is the interest rate used for calculation of the members' annual pensions. Until 1997, the basic interest rate was 4.5 %. In 1997, it was reduced to 2.5 % due to legislation. In 2000, it was reduced to 1.5 %, and on 1 April 2011 it was reduced to 0 % for contribution increases, single contributions and payment of bonus. Consequently, DIP has members with several different basic interest rates.

Both the basic interest rate and the biometric assumptions are different on each set of regulations.

**The total pension**
On Regulation 3 and 4, DIP calculates a basic pension which is conservatively determined as well as a pension based on more realistic assumptions. The realistic assumptions result in a higher pension, and it is this total pension that appears from the pension statement as a benefit. The board can change the assumptions.

The total pension is calculated on basis of an interest rate which is typically higher than the interest rate of the basic pension. Consequently, the pension commitment already includes a high future expected interest payment. Accordingly, the return on investments must be high to ensure additional bonus payments and increasing pensions.

**The supplementary pension**
The supplementary pension is the difference between the total pension and the basic pension. Contrary to the basic pension, the supplementary pension is unfunded. Accordingly, DIP does not make provisions for covering the supplementary pension. The supplementary pension is paid successively from the pension fund's undistributed reserves which consist of the pension fund's equity and collective bonus potential.

The supplementary pension may be adjusted or possibly suspended if e.g. the return does not match the assumptions.

**Previous calculations of the basic pension**
The basic pension is calculated according to a technical basis including a conservative estimate about the future interest payment and assumptions about the members' life expectancy, disability etc. On Regulations 3 and 4, the basis is conditional which means that the pension can be recalculated if the assumptions are changed.

When the bond interest rates have been historically low, and the members still longer than previously assumed, the assumptions for calculation of the basic pension do no longer reflect a conservative estimate. Accordingly, DIP will, for the second time, include a new basic interest rate and increased life expectancy in the calculation of the basic pension for the members admitted to Regulations 3 and 4.

- From 1 November 2011, DIP has included the increased life expectancy for all members on Regulations 3 admitted before 1 July 2009. This also applies to those members who opted for Regulations 3 on 1 January 2007 as well as spouse and child pensioners after these members.

- From 1 November 2015, DIP has included a new basic interest rate of 0.5 % as well as the increased life expectancy for members on Regulations 3 and spouse and child pensioners after these members. For members admitted before 1 July 2009, the adding in of the increased life expectancy only includes contributions increases, single deposits and added bonus. DIP has also included a new basic interest rate of 0.5 % for members subject to Regulations 4 who were admitted before 1 November 2011 as well as spouse and child pensioners after these members.

The changes imply that all members on Regulations 3 and 4 are subject to equal assumptions for calculation of the basic pension.

The changed assumptions for calculation of the basic pension have no immediate impact on your total pension, projected pension, deposit or paid pension as DIP has changed the interrelationship between the basic and supplementary pension by increasing the supplementary pension's share of the total pension. As the share of the supplementary pension increases, the changed assumptions imply that DIP at short notice can change a larger part of your pension e.g. if there are changes in the life expectancy or return.

**The projected pension**

The pension statement includes a projected pension stating the current value of the pension at age 68 based on a number of assumptions. These assumptions may change, and consequently the projection is not binding. Some of the assumptions are social and applicable for the entire pensions industry while others are determined by DIP.

In the projected pension future contributions are adjusted for inflation, and the pension is then discounted with the inflation rate.

DIP calculates individual risk-adjusted premiums on death and disability depending on the member's age, admission date and paid pension contributions.

Besides above-mentioned assumptions, there is a group insurance premium for members covered by the group insurance.

Interest rates, costs and risk-adjusted premiums determined by DIP are the pension fund's bonus rates this year. They are determined annually by the board and notified to the FSA.

The current assumptions of the projected pension appear from dip.dk

**Costs**

On *Min pension* your costs are stated as annual costs measured in DKK (ÅOK) and as a percentage (ÅOP) respectively.

ÅOK and ÅOP show the total costs that you pay during a year - both the direct costs which are deducted from the contribution payments, and the indirect costs which i.e. is paid from the investment return.

ÅOK shows the administrative costs and investment costs respectively. As a member you do not contribute to DIP's equity. ÅOP shows the costs as a percentage of your savings.

Under the tab "Depotoversigt" on *Min pension*, ÅOK is subdivided into:

- Investment costs
- Administrative costs related to the group insurance (the amount is included in the total premium for the group insurance)
- Administrative costs
- Administrative costs of contributions.

**Insurance cost runner**

As part of fostering increased transparency in the pensions industry, all pension companies and pension funds have introduced an insurance cost runner on their web sites. The insurance cost runner is a calculation tool showing the insurance company's or pension fund's level of costs under different assumptions about size and type of pension scheme. The costs are calculated in accordance with an industry standard making the level of costs comparable across the companies. You can calculate your costs on dip.dk

### Contribution groups
Your pension scheme, which is a life annuity scheme based on an average interest rate, is divided into different contribution groups according to interest rates, risks and costs, cf. the FSA's Declaration of Contributions. The contribution groups must ensure that there is no unfair and systematic redistribution among DIP's members. From the pension statement on *Min pension* you can see which contribution groups your pension scheme is subject to.

### Is the pension commitment guaranteed?
This has become a frequently asked question in the pension debate. The question of a guarantee depends on the agreement. In pension funds the framework is normally the collective agreements between employers and employees' organizations.

Generally, it does not make sense to talk about guarantees in a pension fund as it will be the members giving each other guarantees because there are no external owners to cover possible losses.

On admission to the pension fund or in case of changes in salary or employment conditions, members employed under a collective agreement receive a pension commitment. This pension commitment reflects the expected size of the pension - not a guarantee.

New members in DIP are admitted with a basic interest rate of 0 %. The basic interest rate is contingent on a number of assumptions about the future investment return and trends in life expectancy. If these assumptions are not met, the basic pension may be reduced.

The 'Choice of pension' in 2006 resulted in 95 % of the members choosing a new set of Regulations including a basic interest rate of 1.5 % and a conditional technical basis. This means that the guarantee is conditional, and consequently the pension commitments are reduced if certain requirements of the Regulations are met, cf. the paragraph 'The pension commitment'.

Even though there are no guarantees, it is still the pension fund's ambition to pay pensions on par with the total pensions in the pension statements.

## Bonus

Bonus is distribution of a possible surplus generated through a better actual development than assumed on calculation of the basic pensions. This can be lower costs, a better risk profile or a favorable return.

There are clear rules for distribution of the surplus. The individual member is paid a share of the surplus relative to the contribution he/she has made to the surplus.

The rules applying to distribution of surplus are specified in the FSA's Declaration of Contributions. Here it is established that **all** members must be treated fairly, and no special groups (i.e. age groups) should benefit from preferential treatment.

The part of the surplus not distributed as bonus is transferred to the collective bonus potential. The collective bonus potential and the equity are the pension fund's undistributed reserves ensuring that DIP is able to pay the calculated pensions.

In DIP, only the life annuity is eligible for bonus payment and consequently subject to the contribution principle. Annuities certain, retirement insurances and endowment policies are not eligible for bonus as interest is paid at the rate of the actual return, the costs equal the actual costs and there is no insurance cover. The life annuity is a so-called average rate product, while the annuity certain, retirement insurance and endowment policy are market rate products.

## DIP has healthy members

DIP has a significantly good disability profile, and only few members receive disability pension.

Engineers are one of the population groups that live longest, and for the past years the life expectancy has continuously increased for our members as for the rest of the population. It is positive that the members live longer, but it has its downside for the pension fund. The majority of the pensions that DIP pays are life annuities that are paid as long as the member lives. When the members live longer than projected, the pensions must also be paid for a longer time than assumed in the technical basis. On the other side, the costs related to disability are very low due to the low disability rate.

On 1 December 2017, DIP introduced a new technical basis which reflects the members' life expectancy and accordingly the size of the pensions better.

## Individual pension return tax (PAL-taxation)

On 1 January 2010, the pension return tax was changed from company level to an individual level in order to give equal status to pension companies within the EU. This means that DIP must calculate the pension return tax individually for each member and settle it with the Danish Tax and Customs Administration (SKAT).

**Unchanged taxation**
Generally, the change does not affect the pension return tax. There is still taxation at company level also, and the aim is that the total taxation for a pension company and the members remain unchanged compared to the pre-2010 rules.

**Exemption for members abroad**
Members, who are not fully tax liable to Denmark or residing outside Denmark according to a double taxation treaty, can apply to SKAT for exemption from paying individual pension return tax. The application can be downloaded on dip.dk

If you become fully tax liable to Denmark again, you are obliged to inform SKAT and DIP so the pension return tax can be deducted from your deposit.

**Termination and transfer**
If you terminate your pension scheme, DIP settles outstanding pension return tax according to the rules applying. If the pension return tax is negative on termination, it may be paid considering certain statutory limitations.

If you transfer your scheme to another company, DIP does as a general rule, not pay pension return tax but sends the information about pension return tax to the receiving company which ensures final settlement.

The FSA must currently assess pension funds and insurance companies' investment risk compared to the capital requirement. For this purpose, the FSA uses among other things the so-called traffic lights. The traffic lights are a tool to determine a company's ability to withstand a predefined negative financial trend which may occur, but has not occured.

Red light implies that the company has insufficient capital to withstand the results of  a specified negative interest rate and market price trend. Hitting a red light scenario will result in discussions with the FSA about which action to take. Green light implies that the company is in a financial situation that enables the company to withstand negative trends on the financial markets.