

EXAMINATIONS

April 1998

Subject H — Pensions

Paper Two

Time allowed: Three hours

INSTRUCTIONS TO THE CANDIDATE

1. *You have 15 minutes at the start of the examination in which to read the questions. You are strongly encouraged to use this time for reading only but notes may be made. You then have three hours to complete the paper.*
2. *You must not start writing your answers in the booklet until instructed to do so by the supervisor.*
3. *Write your surname in full, the initials of your other names and your Candidate's Number on the front of the answer booklet.*
4. *Mark allocations are shown in brackets.*
5. *Attempt all 4 questions, beginning your answer to each question on a separate sheet.*

AT THE END OF THE EXAMINATION

Hand in BOTH your answer booklet and this question paper.

<p><i>In addition to this paper you should have available Actuarial Tables and an electronic calculator.</i></p>
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- 1 A UK occupational defined benefit pension scheme has a separate additional voluntary contributions (AVC) fund. The trustees' investment policy to date for the AVC fund has been to purchase high yielding gilts and corporate bonds, and to hold these to redemption.

Each year, a bonus rate is declared by the actuary to the AVC fund. The bonus is a percentage of the accrued fund at the start of the year plus an appropriate allowance for contributions in the year. The benefit payable to members is the amount of their AVCs plus declared bonuses plus a pro rata bonus based on the most recently declared bonus for a part year. The pattern of bonuses has been stable (changing by at most 1% each year).

Most members take their AVC proceeds as a cash sum where possible. When members take pensions, they are purchased within the AVC fund itself using annuity rates which are based on current gilt yields. All such pensions have fixed increases in payment.

The AVC fund currently has a positive cashflow. However, the company is expecting to carry out a major redundancy exercise with the result that there will be many more pensioners paid from the fund in the future.

You have been appointed as an advising actuary to the trustees.

- (i) Set out the points you would make in a report to the trustees covering:

- (a) the implications of the AVC fund's investment policy;
- (b) the method of distributing investment returns to members;
- (c) equity between members; and
- (d) the risk that the trustees might not be able to meet the liabilities.

[19]

- (ii) The trustees have asked your advice on how to transfer the existing pensioners from the AVC fund to the main scheme without affecting the expected benefits of the existing AVC fund members. (Following the transfer, all future AVC pensions will be bought out in the main fund.)

- (a) Describe and comment briefly on a suitable method to calculate and implement the transfer.
- (b) Comment on any further assumptions which would have to be made.

[6]

[Total 25]

- 2** Company X operates a final salary pension scheme. There are 10,000 active members, 2,000 deferred pensioners and 1,000 pensioners. The market value of the assets is £500m and the value of the liabilities, as measured on the basis used for the minimum funding requirement under the Pensions Act 1995, amounts to £550m. The assets are invested 70% in UK equities and 30% in overseas equities.

Company X has run into financial difficulties and receivers have been called in. Many of the active members are being made redundant. An independent trustee has been appointed as a trustee of the scheme.

You have been engaged by the independent trustee.

- (i) List the different methods by which the trustee could meet the liabilities of the scheme. State, with reasons, which method you would recommend. [3]
 - (ii) Outline the issues that the trustee should consider when setting the terms for early retirement benefits and for transfer values. [11]
 - (iii) Describe briefly the factors that the trustee should consider in setting the investment strategy for the scheme assuming it continues as a closed fund. [7]
 - (iv) Outline the calculation of the debt on the employer under GN19 and explain why the sum ultimately paid by the employer may not be sufficient to enable the liabilities to be secured. [5]
- [Total 26]

- 3** A large industrial company has demerged part of its business (Newco). Newco will set up a pension scheme providing identical final salary benefits and into which a bulk transfer will be paid in respect of active and former employees of that division. The bulk transfer will be on a share of fund basis (which includes a modest surplus), using the assumptions adopted for the most recent valuation of the transferring scheme. You have been appointed by the trustees of the Newco pension scheme to undertake the initial actuarial valuation.

- (i) List the information that you would require. [4]
 - (ii) Outline the investigations you would make prior to undertaking the valuation. [7]
 - (iii) Discuss with reasons what method and basis you might use to establish the company's initial rate of contribution. [11]
- [Total 22]

4 Following the sale of a UK subsidiary company, a group of members of a final salary scheme to which you are Scheme Actuary are to be transferred, without their consent, to a final salary scheme to be established by the purchasing company. The vendor has agreed with the purchaser that a bulk transfer payment is to be paid in respect of their past service rights. The trust deed of the vendor's pension scheme provides that a bulk transfer can be paid in this situation and that the amount to be transferred is to be decided by the trustees of the scheme on the advice of the Scheme Actuary.

- (i) Set out the statutory requirements which need to be met before the transfer can proceed. [3]
- (ii) Discuss the points to consider when advising the trustees of the vendor's scheme on the amount of this transfer payment. [12]
- (iii) It has been proposed by the purchasing company that the potential transferring employees remain members of the vendor's pension scheme for a period of six months, by which time the new scheme would have been established.

State the considerations which should be borne in mind when advising the trustees of the vendor's scheme on the suggestions that:

- (a) at the end of the six month period a direct transfer of equities should be made from the vendor's scheme into the new scheme; and [5]
- (b) the amount of equities transferred would be equivalent to the agreed transfer amount at the date of completion of the sale in respect of the potential transferees, increased with interest equal to the base rate of a major UK clearing bank for the six month delay period. [7]

[Total 27]