

EXAMINATIONS

April 1999

Subject 404 — UK Fellowship Pensions*Paper Two*

**You must answer this subject only,
you may not attempt another subject in the 400 series.**

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 both 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.

*In addition to this paper you should have available
Actuarial Tables and an electronic calculator.*

1 A UK company currently runs a defined benefit final salary scheme for its employees. The current fund size is £50million. The last actuarial valuation on an ongoing basis used the Projected Unit Method and disclosed that liabilities were split 40% active members 50% pensioners and 10% deferred pensioners. The scheme was 130% funded on the MFR basis. Pensions in payment increase in line with Limited Price Indexation.

(i) Outline the issues that the trustees should consider when determining the investment policy for the scheme. [11]

(ii) Discuss how an asset liability modelling exercise could assist the trustees in determining an appropriate investment policy.

Briefly describe the limitations of such an exercise. [8]

(iii) Describe how your answer to part (i) would have been different if the funding level on the MFR basis was only 100%. [8]

The company has become concerned at the long term cost of running a defined benefit final salary arrangement but still wants to provide pension benefits for its employees. It is considering the following three options:

(Option A) to close the scheme to new entrants, who will join a separate money purchase arrangement, but continue with the existing benefit structure for current members

(Option B) to cease further accrual under the scheme and grant current members deferred pensions as if they had left service. A money purchase category would be introduced within the scheme for future service and for new entrants

(Option C) to wind up the scheme and introduce a group personal pension plan

(iv) Outline the advantages and disadvantages to the company of each of these three options. [12]

(v) Describe the changes to their investment policy in relation to the defined benefits that the trustees should consider under each of the above scenarios. [6]

(vi) Outline the non investment issues that the trustees will need to consider if the company wishes to proceed with any of the proposed changes. [10]

[Total 55]

- 2** A large UK conglomerate is planning to embark on a programme of corporate disposals likely to entail ten substantial deals and a similar number of much smaller deals. Currently, 95% of its employees are members of its approved final salary scheme.

You have recently advised the company that the approved scheme is 170% funded on a basis you consider realistic (i.e. which allows for the expected return on equity investments). The formal actuarial valuation carried out two years ago disclosed a surplus of 35% of its liabilities, although you estimate that a valuation on the same basis now would disclose a surplus of around 30% of the liabilities.

The scheme has a history of the company taking contribution holidays in return for discretionary benefit increases for members. Employees whose benefits are restricted because of the earnings cap have no additional benefits.

The finance director has been recruited recently and has little experience of the pensions aspects of corporate sales. He has asked you to provide him with a briefing paper as to how the company should prepare for the pension aspects of the disposals. The paper should set out:

- (i) a brief summary of all the parties (excluding advisers) involved and their interests [13]
- (ii) a brief outline of how the pensions aspects of deals where a final salary scheme is involved are usually structured; and [10]
- (iii) your recommendations for his strategy for the programme of disposals including:
 - (a) justification of all your recommendations
 - (b) details of how he should negotiate on the terms for pensions (precise details of bases not required), and
 - (c) the preparatory actions and decisions he should take to ensure the programme goes through smoothly and in the company's best interests. [17]

[Total 45, including 5 marks for drafting]