# EXAMINATIONS

7 April 2003 (pm)

## 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. *Enter all the candidate and examination details as requested on the front of your answer booklet.*

2. *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.*

3. *You must not start writing your answers in the booklet until instructed to do so by the supervisor.*

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, with any additional sheets firmly attached, and this question paper.*

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

**1** A large UK company ABC plc has decided to sell part of its business to Newco plc.

ABC plc operates a defined contribution scheme with an age related contribution scale. At retirement, members are able to convert their accrued fund to a pension on the more favourable of either:

- open market annuity rates
- fixed annuity rates (i.e. using fixed investment and mortality assumptions)

In addition, a director of ABC plc who is transferring to Newco plc has a "promise" from ABC plc that contributions paid on his behalf to his defined contribution account will vary in the period to his retirement to target a pension of 1/60ths of his final salary for each year of service. The contribution rates payable are subject to review on an annual basis. The next review date is coincident with the anticipated completion date.

Newco plc does not operate a pension scheme but intends to establish a career average revalued earnings (CARE) scheme for all its employees. ABC plc and Newco plc have agreed that Newco plc should participate in the ABC plc pension scheme for the first year.

At the date of completion, open market annuity rates are identical to the fixed rates guaranteed under the scheme. The annuity rate guarantee has never applied in practice in relation to any previous retirements. The assets of the scheme are equal to the sum of the accumulated funds for each member.

You have been retained by ABC plc and asked to advise in relation to the following issues:

(i) The appropriate contribution rate payable by Newco plc to the ABC plc pension scheme to cover:

- the director's benefit
- benefits for other members
- the impact of the annuity terms

over the participation period. [12]

(ii) A fair transfer value basis to determine the funds transferred to Newco plc's pension scheme at the end of the participation period. [10]

(iii) The suitability of a CARE scheme as the recipient of the transferring liabilities. [7]

(iv) The factors that individuals will need to take into account when deciding whether or not to transfer their accrued rights and convert them into a period of service under the CARE scheme. [7]

(v) A suitable investment strategy for the ABC plc pension scheme to adopt in relation to the assets supporting the accrued pension entitlements of transferring members. [6]

Discuss the points you would make in a report to the directors of ABC plc covering these areas, making explicit reference to the factors that you would take into account in determining your recommended approach in each case.

[Total 42]

**2** As Scheme Actuary you have recently reported the results of an actuarial valuation of a UK final salary pension scheme currently open to new entrants. The valuation has been carried out using the Projected Unit method. On the basis of the long term valuation assumptions you have recommended that the company increases its contribution rate from 12% to 15% of Pensionable Salaries. The Finance Director is concerned at the rising costs of pension provision and has asked you to report on the risks to the company that the next valuation will require a further significant increase in the contribution rate.

(i) Draft your reply to the Finance Director which should include, but not be limited to, comments on the funding method, experience versus assumptions and additional factors that may change the rate. [26 (including 6 for drafting)]

The Finance Director has indicated that the company does not wish to pay the contribution rate you have recommended but wishes to pay the minimum level of contributions allowed under the Minimum Funding Requirement. He has also stated that the company intends to close the final salary scheme to new entrants and offer a separate defined contribution pension arrangement to new employees. Existing members of the final salary scheme will be offered the opportunity to switch to the new defined contribution arrangement for future service or continue to accrue final salary benefits.

(ii) Describe the additional points that you would make to the Finance Director regarding the stability of the future company contributions for pensions. [8]

(iii) Set out the areas that the trustees will need to consider before responding to the company on its proposals. [8]

(iv) Set out the additional points that individual members will need to consider before deciding whether or not to switch to the new defined contribution arrangement. [16]

[Total 58]