EXAMINATIONS

6 April 2001 (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. *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.*

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.

The following are extracts from a booklet describing the benefits provided by the long established money purchase pension scheme of a UK company. The scheme is not contracted–out of SERPS.

Retirement age:	65
Contributions:	Contributory salary is basic salary as at 6 April. Scheme members pay 6% of contributory salary. Employer contributions are 4% of contributory salary. The employer will not contribute to any private pension arrangement for employees. The employer will not contribute to a stakeholder pension.
Investment:	Contributions are invested in units of one or more of the following funds which are managed by a firm of pension consultants. Cautious Fund — Funds are invested in cash deposits and secured commercial mortgages. The capital value of the units is guaranteed. The investment return is generally better than can be obtained in a bank or building society. The investment income is tax free. Protection Fund — Funds are invested in retail price index (RPI) index linked gilts. The investment return will normally be better than that on the Cautious Fund but the value of the units can go down. The investment return on the fund is tax free. Lifestyle Fund — Funds are invested in a mixture of UK equities (stock market shares) and RPI index linked gilts (UK government securities). The investment return will normally be better than that on the Cautious Fund and Protection Fund. The value of the units can go down. The investment return on part of the fund is tax free. 100% of each member’s fund is invested in UK equities until 10 years before retirement. Over the next 10 years the funds are gradually switched into RPI index linked gilts. Adventurous Fund — Funds are invested in a mixture of UK and overseas equities. The investment return will normally be better than that on the other Funds. The value of the units can go down. There is a tax charge in respect of dividend income. Scheme members can choose how much of the fund accumulated on their behalf will be invested in each of these funds. If any member does not want to make a choice, their fund will be invested in the Cautious Fund. Members may change their investment choice on 6 April each year.

Pensions:	When the member retires, 10% of the fund will be paid out as a cash sum and the balance will be used to buy a pension from an insurance company. The pension will increase in payment in line with increases in the RPI and will continue to the member's spouse at a rate of 50% following the member's death. The pension at retirement will be restricted to the maximum permitted under Inland Revenue limits.
Death in service:	A lump sum payment of $3 \times$ contributory salary is payable. In addition, if a married member dies before retiring, the fund will be used to buy from an insurance company a pension for their spouse. If there is no surviving spouse, the trustees have the discretion to pay the fund to a dependant.
Leaving service:	The member's accumulated fund will be retained in the scheme. Alternatively the member may take a transfer value to another occupational pension scheme or to a personal pension scheme.

Josiah Smith is aged 48. He has just started working for this company and will be paid a basic salary of £30,000 per annum. He will also receive commission and bonus payments of up to £20,000 per annum. He has been offered membership of the money purchase scheme from 6 April 2002 and has asked for your advice. (You are authorised to give personal financial advice.)

For the last 8 years he has paid £200 per month into a personal pension arrangement with a life insurance company. No other money has been paid into his pension. He has told you that his personal pension fund is invested in UK company shares. He has never been a member of a company pension scheme and has made no other pension arrangements.

He says that he does not think he should join the money purchase scheme and has given you the following reasons.

- If he joined the scheme he would be paying less than he is currently paying which does not seem to make sense. He was already thinking of increasing his payments so that he could buy a decent pension at age 60.

- His personal pension will not be subject to any limits. The company pension could be and he could lose money if his pension has to be cut back.

- The investment funds on offer are not attractive. The Cautious Fund will probably give a very poor return. The other funds sound too risky — he could lose money on them. Also he doesn't want to pay tax on any of his pension investment. His current investments have always shown a healthy year on year return and currently amount to £27,500.

- He has heard that if he doesn't stay with his new employer his pension will be frozen and he will get a very poor pension when he retires.

- The scheme provides a pension from age 65. He wants to retire at age 60.

 PLEASE TURN OVER

- Although he expects to have a long and healthy retirement, inflation is very low now and so he does not see the point of a pension which increases in payment.

- A widow's pension would be no use to him, as he is not married to his partner.

Draft a response advising Mr Smith about his pension arrangements and the choices he should make. This should include the differences between employers' occupational pension schemes and personal pension schemes. Your response should cover the following and take into account the points made by Mr Smith:

(i) investment considerations [16]

(ii) expense considerations [3]

(iii) contribution options and limits [9]

(iv) a desirable level of pension in retirement and the contribution necessary to provide it at age 60 or age 65 [24]

(v) the nature of retirement benefits and limits that apply [13]

(vi) death benefits and limits that apply [4]

(vii) leaving service benefits [7]

(viii) your recommendations, including questions that should be addressed to the scheme [14]

[additional 10 marks for drafting]
[Total 100]