

# EXAMINATIONS

20 September 2004 (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.*

### **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.*

A large UK chemical manufacturing company operates a final salary scheme for its UK employees. The scheme provides the following benefits:

- a pension on normal retirement at age 65 of  $1/60^{\text{th}}$  of final pensionable earnings for each year of service, where pensionable earnings equals gross pay, and final pensionable earnings equals the best pensionable earnings figure in the five years prior to leaving, death or retirement
- a lump sum on death in service equal to three times pensionable earnings
- a spouse's pension on death in service equal to 50% of the member's prospective pension based on service to age 65 and pensionable earnings at the date of death
- a spouse's pension on death in retirement of 50% of the member's pre-commutation pension plus a five year guarantee
- statutory pension increases in payment and deferment
- a pension on early retirement at or after age 60 equal to the accrued pension without reduction for early payment, subject to the consent of the company

The scheme is not contracted-out of the State Second Pension and was closed to new entrants two years ago.

A valuation of the scheme has recently been carried out on the attained age method and the Scheme Actuary has used the following assumptions:

Discount rate pre retirement	5.0% per annum
Discount rate post retirement	5.0% per annum
General levels of pay inflation	3.5% per annum
Pension increases in payment	2.5% per annum
Revaluation in deferment	2.5% per annum
Price inflation	2.5% per annum
Mortality	Latest tables (plus future improvements)
Retirement age	50% at age 60 25% at age 62 25% at age 65
Withdrawals	No allowance
Promotional salary scale	0.5% per annum
Proportions married	90%

The scheme rules state that the company contribution rate is “agreed by the trustees and the company acting on the advice of the Scheme Actuary”. The company is concerned by the escalating cost of the scheme and feels that the Scheme Actuary may have been too conservative in her approach. You have been appointed to provide advice to the company.

- (i) List the roles and duties of:
  - (a) the trustees
  - (b) the Scheme Actuary
  - (c) the company

[10]
- (ii) Discuss the issues that you would recommend the company raises with the Scheme Actuary when discussing future funding requirements. [24]
- (iii) Discuss the issues the Scheme Actuary should consider when deciding whether or not to advise the trustees to accept a proposal from the company to fund the Scheme on a less conservative actuarial approach. [9]
- (iv) Discuss how the advice of the Scheme Actuary might differ if the contribution clause in the rules states that the company contribution rate is “established by the trustees acting on the advice of the Scheme Actuary”. [9]
- (v) Outline how the advice of the Scheme Actuary might differ if additionally legislation requires solvent employers to meet in full the pension promises made to their employees. [5]

In the circumstances where the trustees have the power to set the contribution rate acting on the advice of the Scheme Actuary, solvent employers are obliged to meet in full the pension promises made to their employees, and there is an Insolvency Protection Fund (which guarantees the full pension promise made to employees of companies that subsequently become insolvent).

- (vi) Outline how the advice of the Scheme Actuary might differ. [5]
- (vii) Describe the factors that the trustees should take into account in establishing an appropriate investment strategy for the scheme. [20]
- (viii) Describe the factors that the trustees should take into account in establishing an appropriate transfer value basis for deferred pensioners who wish to transfer their benefits to an alternative arrangement, including in your answer any specific considerations which could apply if the scheme is not fully funded on the preferred transfer value basis. [18]

[Total 100]

**END OF PAPER**