EXAMINATIONS

13 September 2002 (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 UK based Group owns five UK Industrial Companies. The Group is now considering rationalising its pension benefits and merging the existing arrangements into one centralised scheme.

Four companies currently run their own pension arrangements. Company A and B have self administered final salary arrangements with the following details:

	Company A	*Company B*
Scheme Type	Final Salary	Final Salary
Contracted out	Yes	No
Active members	4,000	2,000
Deferred members	2,000	1,000
Pensioners	3,000	5,000
Fund Size	£400m	£700m
MFR funding level	140%	90%
Normal Retirement age	65	65
Pension at retirement	1/60th of Final Pensionable Salary for each year of Scheme Service	1/80th of Final Pensionable Salary for each year of Scheme Service
Company contribution rate	15% of basic salary	10% of gross earnings
Member contributions	5% of basic salary	3% of gross earnings
Pensionable Salary	Basic salary	Gross earnings in previous tax year
Final Pensionable Salary	Pensionable Salary in preceding 12 months	Best three year average of Pensionable Salary in preceding 10 years
Pension increases	Statutory plus a history of Retail Price Index discretionary increases	LPI on all benefits
Lump sum death in service	4 times basic salary	2 times Pensionable Salary
Early retirement	With employers' consent — no reduction after age 60	Actuarially reduced
Spouse's pension	50% of member's accrued pension	50% of member's pension (based on prospective service if death in service)

Company C has a self administered occupational money purchase scheme with 1,500 contributing members, 1,000 deferred pensioners and 500 pensioners. The Scheme is not contracted-out. Both the Company and the members contribute 5% of gross earnings. The fund is currently valued at £25 million. Death in service benefits of four times basic salary and a spouse's pension of 20% of basic salary are provided.

Company D has an insured Group Personal Pension Scheme with 500 contributing employees where the employer pays 5% of basic salary and the employees pay 3% of basic salary. Lump sum death in service benefits of two times salary are provided.

Company E, with approximately 200 employees, does not currently contribute to any pension arrangements.

It has been decided to merge all the pension arrangements into Company A's pension scheme which will then become the Group pension arrangement. Benefits in respect of service to date will remain unchanged. Future benefit accrual for all employees in the Group will be on the current Company A scheme structure.

(i) Outline the advantages and disadvantages to the Group of merging all of the pension arrangements into one centralised scheme. [10]

(ii) Describe the issues that the trustees of the three self administered arrangements will need to consider before agreeing to the merger. [14]

(iii) Outline the advantages and disadvantages for employees of each of the five companies of the proposed merger. [18]

(iv) Outline the issues which would need to be covered in an initial announcement to employees of Company C when they are first informed of the proposed merger. [8]

[Total 50]

PLEASE TURN OVER

2 (i) Describe the reasons why an actuarial valuation is undertaken for a defined benefit pension scheme in the UK. [8]

(ii) You are the actuary to a defined benefit scheme in the UK. You currently perform regular valuations of the scheme, for the Trustees, using a traditional discounted cash flow approach. One of the Trustees has recently attended a course of Trustee training where other methods were discussed. She has asked you to prepare a report to the Trustees on the options available.

Draft your report. [5 marks are available for drafting]
[23]

The scheme provides a lump sum to each member, or their estate, at the end of the year in which they are or would have been aged 60. Currently the amount of the lump sum is £100,000.

Benefits are linked to inflation and rights vest immediately on joining the scheme. There are no other benefits.

The current value of the assets are as follows:

UK listed equities:	£1,980,460
UK gilts:	£20,120
UK fixed interest:	£180,240

The current date is 31 December 2001.

The current Minimum Funding Requirement (MFR) position is that the scheme is approximately 120% funded. Already weak equity markets have now fallen to a 40 year low, although this has had the effect of bolstering the fixed interest market.

As a result, the assets of the scheme now stand as follows:

UK listed equities:	£982,460
UK gilts:	£29,030
UK fixed interest:	£229,640

The MFR position has now fallen to 85% funded.

(iii) Outline the issues you would cover in a report to the Trustees when presenting the effect. [19]
[Total 50]