INSTITUTE AND FACULTY OF ACTUARIES

EXAMINERS' REPORT

April 2019 Examinations

Subject SA4 – Pensions and other Benefits Specialist Advanced

Introduction

The Examiners' Report is written by the Chief Examiner with the aim of helping candidates, both those who are sitting the examination for the first time and using past papers as a revision aid and also those who have previously failed the subject.

The Examiners are charged by Council with examining the published syllabus. The Examiners have access to the Core Reading, which is designed to interpret the syllabus, and will generally base questions around it but are not required to examine the content of Core Reading specifically or exclusively.

For numerical questions the Examiners' preferred approach to the solution is reproduced in this report; other valid approaches are given appropriate credit. For essay-style questions, particularly the open-ended questions in the later subjects, the report may contain more points than the Examiners will expect from a solution that scores full marks.

The report is written based on the legislative and regulatory context pertaining to the date that the examination was set. Candidates should take into account the possibility that circumstances may have changed if using these reports for revision

Mike Hammer
Chair of the Board of Examiners
July 2019

A. General comments on the *aims of this subject and how it is marked*

1. The aim of the Pensions and other Benefits Specialist Applications subject is to instil in successful candidates the ability to apply knowledge of the pensions and employee benefit environment and the principles of actuarial practice to providers of pensions and employee benefits both in the United Kingdom and the rest of the world.

2. This subject examines the ability of candidates to apply actuarial practice and concepts to potentially complex problems, integrating their analysis into a coherent whole, and evaluating and interpreting results to draw explicit conclusions.

3. From 2019 the requirement for detailed knowledge of the UK's legislative and regulatory frameworks has been moved to the UK Practice Modules (UKPM). The Specialist Advanced subjects will still require knowledge of the principles of the UK market and regulatory regimes but there has been a re-balancing to include comparison between different jurisdictions and expansion in non-UK-specific topics.

4. The Examiners therefore look for candidates to demonstrate their understanding of the syllabus but in particular they need to demonstrate ability in applying their knowledge and core actuarial skills to the specific situations that the Examiners have raised, having read the question carefully. Consistently, many of the unsuccessful candidates provide answers that are not sufficiently specific to the subject matter of the question, reproduce core reading that does not directly relate to the question context, or focus on one specific point without covering a sufficient range of points to answer the question. This does not enable the candidates to achieve the required marks. The Examiners encourage future candidates to remind themselves of what they learned in the Core Actuarial subjects, and to use past paper questions to practice applying these skills to the specific scenarios tested.

5. Good candidates demonstrate that they have structured their solutions well – this is a big advantage in making points clearly and without repetition. There is a significant incidence of points being repeated in slightly different ways, restricting the scope for candidates to score marks. Good structure enables candidates to use the latter parts of questions to generate ideas for answers to the early parts (or use their solutions to earlier parts of questions to create a structure for latter parts). Time management is important so that candidates give answers to all questions that are roughly proportionate to the number of marks available. The questions are set so that it should take approximately twice as long to answer a 10 mark question as a 5 mark one. Answers should therefore be similarly proportionate.

6. In addition, candidates should carefully consider the instruction – for example an instruction to list points should be answered with a list without attaching discussion. Similarly, a question asking for a discussion cannot be answered with a list of undeveloped points.

7. Finally, it is very helpful to the Examiners if candidates clearly identify points made; if they are set out clearly, well-spaced and easily legible. Whilst there is no loss of marks for not doing so, doing so does make it easier to identify scoring opportunities.

8. Candidates who give well-reasoned points, not in the marking schedule, are awarded marks for doing so.

B. Comments on *student performance in this diet of the examination*

This was seen to be a fairly balanced exam with a mixture of knowledge based questions and core application. There were some more challenging parts designed to make candidates think about the question, where the better prepared did well.

As with previous years the application aspects of the course are harder to score well on. This is an area that SA4 candidates consistently need to work harder on in preparation. By taking a methodical approach to answers, step by step, however, there are opportunities to score well. It is important that candidates make sure they provide a full answer to all questions.

The importance of structure in the exams should not be underestimated because this will lead to much more efficient work post exams. It is harder to get good marks in the absence of a good structure because it means that logical points are more likely to be missed. Sometimes points are just repeated further through the answer meaning that the response was more likely to look of sufficient length than it really was for the marks available.

Breaking the question down into smaller parts helps to make sure that a suitable breadth of answer is supplied. It is critical that candidates check that their answers specifically refer to the details of the question, using all of the information in the question pre-ambles. It is not the intention of the examiners to include information in the questions that is not relevant to the answers.

Candidates should take note of the command verbs used to guide the depth given in their answers (a list of what is expected for each verb is available on the IFoA website).

Candidates should also note the number of marks available for each question as a guide of how many points they need to cover.

C. Pass Mark

The Pass Mark for this exam was 57.

Solutions for Subject SA4 – April 2019

Q1 (i) To be attractive to current employees [½]
And to prospective employees [½]

With easy to explain/communicate benefits [½]

That are competitive in the market place [½]

To be consistent with the values and general culture of the business [½]

For example, a more paternalistic employer may prefer a design with greater guarantees [½]

To meet members' needs [½]

The cost to be low/within tolerance [½]

Contributions to meet cost to be affordable [½]

And predictable [½]

To take advantage of any tax concessions that are available to the employer [½]

And for the employees [½]

For the administration to be easy to undertake [½]

And at a low cost [½]

Integration with state benefits [½]

To be consistent with existing work based pension schemes offered by the group [½]

Aid with manpower planning [½]

Compliance with any regulations/legislation [½]

And with the remuneration and other benefit packages offered by the employer [½]

[Max 6]

(ii) The defined benefit scheme could offer a pension that is related to final or average revalued salary [½]

So that members who remain in the scheme until they retire receive a pension that is related to a salary that is likely to have risen by more than price inflation over the duration of their membership [½]

For members who leave the scheme before they retire, their benefits will increase during the period of deferment [½]

Increases could be in line with price inflation, earnings inflation [½]

Or even fixed [½]

With a cap to limit liability in case of high inflation [½]

And a floor to increases [½]

Particularly for benefits in payment [½]

For example in the UK:

The minimum increase is equal to the lower of 5%/2.5% compound for each complete year of deferment or the increase in CPI over the whole period (or other example) [1]

Once the member is in receipt of their pension, further increases will apply [½]

There is a statutory minimum increase that is required to be paid [½]

Although typically, many private sector schemes offer increases higher than the statutory minimum [½]

Albeit that the measure of inflation is now usually CPI rather than RPI [½]

A further approach that can be adopted to protect against inflation once the pension is in payment is for the trustees to award discretionary increases [½]

Although this approach is now relatively unusual because the financial position of many schemes makes it unaffordable [½]

And in any case, it is unusual for discretionary increases to be directly linked to an inflation measure [½]

[Max 6]

(iii) Sponsor's overall objectives… [½]
…eg, is the sponsor aiming for actuarial cost-neutrality or to save costs overall? [½]
Cost neutrality on what basis – accounting/funding… [½]
Or remove inflation risk [½]
Which members will be eligible for the offer [½]
…for example will it also apply to current pensioners or just future pensioners? [½]
For how long will the offer be in place (indefinitely or for a period of years) [½]
Will the terms be fixed or subject to periodic review [½]
Overall cost/ impact on the sponsor's balance sheet, which depends on… [1]

- Likely take-up rate/incidence of retirement… [½]
- …impact will be minimal in the short term if offered to future retirees only unless a significant number of retirements are expected [½]
- How statutory minimum increases overall compared to the current rate of full inflation… [½]
- …eg in the UK statutory increases are price inflation or 2.5% pa if lower for pensions accruing after 6th April 2005 (5% pa if lower for pensions accruing between 6th April 1997 and 6th April 2005 and no statutory

minimum for pensions accrued before 6th April 1997)
(credit any valid example) [1]

What is overall effect on cost/impact on funding/solvency [½]
Any guidance from or restrictions set by regulators… [½]
…for example requirements to offer, and pay for, individual financial advice to members [½]
Also consider discrimination [½]
And scheme documentation [½]
Selection risk [½]
Terms should be generous enough to encourage take up [½]
Also might want to improve solvency position [½]
[Max 5]

(iv) A lot of the consideration that the sponsor has will also be relevant for the Trustees, although from the perspective of the members [1]

They will want it to be fair across the membership [½]

The trustees will expect the initial pension at retirement to be higher for those that exercise the option… [½]
…unless statutory increases are the same as, or in excess of price inflation (which is not the case in the UK) [½]
Or there is another incentive provided [½]
Such as cash in hand [½]
Why has the employer proposed this? [½]
Who has the balance of power in relation to amending benefits [½]
What is the relationship between employer and trustees [½]
Could the Trustees make it conditional on higher contributions [½]
Trustees will want to seek actuarial advice [½]

And the size of this increase will be an important factor [½]

Including the basis upon which it will be calculated [½]

And how the value of the modified pension relates to the value before modification [½]

On various actuarial bases [½]

Such as funding/best-estimate/solvency [½]

Often the value after modification will be lower than before the modification [½]

The trustees will want to consider whether advice or guidance should be made available to the member [½]

And if so will be interested to know the cost of that advice [½]

And who will be required to meet it [½]

Noting that advice is rarely provided in relation to other member options such as cash commutation at retirement [½]

The trustees will be interested in the communication material that will be provided to the member [½]

To ensure that it is clear, factual and unbiased [½]

And sufficient to enable the member to make a fully informed decision when exercising the option [½]

And that enough time is provided for the member to consider the option and take any necessary advice [½]

Noting vulnerable members [½]

The trustees will be interested to know the expected implication of the option on the funding and solvency position of the scheme [½]

And whether any reduction in liability should be anticipated in calculating contribution requirements in the future [½]

The trustees will be interested to know how the option will impact expected cash-flows from the scheme [½]

Noting that the nature of increases on such cash-flows will be different for those that take up the option [½]

So that there may be an implication for investment hedging arrangements [½]

The trustees will want to ensure that the option is permitted under the terms of the trust documentation [½]

And that the administration system is able to cope with the new increase formula [½]

The trustees are likely to want to take legal advice to ensure that their decision is consistent with their legal obligations under the trust [½]

Who will meet cost of exercise? [½]

The trustees will be interested to know whether additional 'at retirement' options are also to be made available [½]

Or whether a partial modification would be permitted [½]

[Max 10]

(v) Is the pension material? If it is a relatively small part of the members income after retirement, then the option may be of little significance [½]

Consider any financial advice receieved [½]

Assuming that the pension is material, the member should consider the size of the increase to the pension at retirement [½]

And their need for a higher immediate pension [½]

For example, if that is necessary to meet expected core living expenses after retirement [½]

Or their desire for a higher immediate pension [½]

For example, to finance higher leisure costs in the period after retirement [½]

When it is likely that the member will be relatively healthy compared to later in retirement [½]

The member should consider the consequences of a relatively lower level of pension later on in retirement [½]

When costs of providing care can escalate significantly [½]

And whether they have access to resources to meet those costs (such as savings or property) [½]

The member should consider the tax consequences of the offer [½]

For example a higher immediate pension may increase income tax [½]

Which would further reduce the net value of the option to the member (noting that the terms of the option are already likely to have reduced the overall value of the pension) [½]

The member should consider their health and whether they expect to have higher or lower than average life expectancy [½]

Those with impaired life expectancy would benefit from a higher immediate pension [½]

Although they may obtain even greater advantage by transferring to a defined contribution scheme and taking income from a drawdown arrangement [½]

The member will want to consider the knock on implications of the option including the impact on cash commutation and spouses pension (if any) [½]

The member may have a personal view on the outlook for future inflation which may make the offer look attractive (or not as the case may be) [½]

[Max 8]
[Total 35]

(i) This was mostly answered very well. There were a few instances of candidates spending extra time explaining points where the command verb was to list. Also some candidates made the same point in different ways so they had to make more points to get the marks available.

(ii) Quite a few candidates seemed to struggle a bit with this question and I think that was probably because they focused on the information given in the preamble rather than thinking in more general terms as the marking schedule suggested. That led to excessive detail about lags and the use of different inflation indices and missed much more obvious points.

(iii) Generally very well answered.

(iv) Most candidates picked up some marks easily, but many didn't make enough points for the number of marks available. A lot of candidates seemed to give the same amount of points to part (iii), (iv) and (v) despite the different amounts of marks on offer. The best candidates were able to think more widely and score very well.

(v) This was generally answered quite well but few candidates scored really well and some clearly had difficulty putting themselves in the situation of being faced with this offer.

Q2 (i) Provides a definition of employer covenant as the legal obligation and financial ability to support the scheme now and in the future [½]
Or the ability and willingness to pay contributions [½]
That funding and investment decisions should be based on an assessment of the strength of the covenant [½]
That the decision making process leading to the conclusions of that assessment should be appropriately documented [½]
Any assessment should be proportionate to the significance that reliance on employer covenant has to the security of member benefits [½]
That external professional advice should be taken, particularly where internal experts may be subject to conflict or the necessary internal expertise does not exist [½]
That trustees should seek to work in collaboration with the sponsoring employer [½]
That the assessment should focus primarily on the legal entities that have the direct obligation to support the scheme and that limited reliance should be placed on any legal entity that only has an indirect obligation [½]
That the assessment should bear in mind the actual funding and investment risks faced by the scheme [½]
The assessment should consider the ability of the sponsor to support the scheme during the whole period where significant reliance may be placed on the sponsor covenant [½]
The trustees should ensure that they understand how the scheme will benefit from any capital investment plans of the employer [½]

Trustees should consider regulatory requirements [½]
The trustees should have appropriate contingency plans in place if the covenant strength changes quickly, and ensure that the position is monitored regularly [½]

And how the covenant is monitored going forward [½]

[Max 5]

(ii) The first consideration is materiality – if the security of member benefits has little dependency on the covenant strength, then the advice will have little regard to the covenant [½]

This might be the case if the scheme is very well funded with investment and longevity risks well hedged [½]

Need to consider short term and long term position [½]

In other situations, the degree of prudence in the funding basis should have regard to the employer covenant [½]

For a weak covenant, the trustees will have less reliance on the employer's ability to support the scheme in the long term [½]

But the best support for scheme in long term is solvent employer [½]

And are therefore more likely to need to have the assets to secure member benefits without further employer support in the relatively near term [½]

This would imply that a more prudent assessment be taken in such circumstances [½]

Noting further that the trustees may have taken steps to reduce investment risk so that there may be less scope for judgment in the funding advice [½]

In addition, the covenant strength will be a factor when considering the length of any contribution requirements [½]

And the strength of the funding basis [½]

And a weak covenant would imply that a shorter recovery plan is required for the same reasons as above [½]

And a strong covenant would imply that the trustee may be prepared to agree a longer recovery plan [½]

Although if the employer can afford to pay, the trustee may wish to take advantage of this situation by requesting higher contributions in the short term [½]

And conversely if the employer cannot afford to pay, then the trustee may be prepared to accept lower contributions [½]

Particularly where they are confident that the employer investment plans will generate enhanced member security [½]

Possibly consider a less prudent approach if insolvency would lead to reduced benefits [½]

Consider other support such as contingent assets [½]
[Max 5]

iii) The financial director of the company [½]

Any other company officers with information about the profit warning [½]

The external covenant assessment provider [½]

The scheme lawyer [½]

Company's actuary/legal advisor [½]

The investment consultant [½]
[Max 2]

(iv) Review revised projections for key financial metrics [½]

Have these changed beyond the time period implied by the profit warning (likely to be through to the end of the financial year at most) [½]

What are the trends in the accounts/management accounts? [½]

What assets are available to scheme on insolvency [½]

Impact on price/yield of other traded securities of the company, and in particular any corporate debt [½]

Conduct further analysis to consider the change to implied market default risk rate for the company [½]

e.g. Merton model [½]

How have the credit rating agencies responded? [½]

If no immediate change, is this likely in the near term? [½]

Obtain further information from the company as to the reasons for the profit warning [½]

Is this caused by a specific situation that is unique to the company, and short term in nature (eg a one-off production failure in the supply chain) [½]

Or are the causes likely to persist in the future, and if so, for how long [½]

What actions are the company considering to address the causes? [½]

Are the causes impacting other companies in the same sector/industry outlook [½]

And is it possible that there will be some consolidation as a result? [½]

Updated analysis from the external covenant assessor could be requested [½]

Starting with a short report based on a quick analysis and advice on whether further work is needed [½]

And if necessary a more exhaustive update of the independent business review [½]

Note, the extent to which the company is prepared to collaborate in these efforts is a key indicator of the extent to which the trustees should be concerned [½]

[Max 7]

(v) The trustee may request additional monitoring be put in place to ensure timely notification of any further deterioration in the company covenant [½]

And the engagement of an external covenant assessor if one has not been appointed to date [½]

The trustee could consider a change to the investment strategy [½]

Noting that a weaker covenant is less able to support investment risk [½]

The trustee may request actuarial advice on the impact of the deterioration on the funding position assuming no change to the investment strategy [½]

And advice on an appropriate funding/technical provisions basis if there is a change to a less risky investment strategy [½]

The trustee may also request advice (from the actuary and covenant assessor) on the need to change the funding strategy/recovery plan [½]

The trustee may commission a further actuarial valuation to get an up to date assessment of the funding position of the scheme [½]

And undertake scenario analyses on how this could develop in the future [½]

Reflecting any necessary information from the causes of the profit warning [½]
As a result of the above analysis, the trustee may request additional contributions are made to the scheme [½]

Or that member security is enhanced in a different way [½]

e.g. contingent assets/contributions [½]

Could consider credit default swaps, although probably too expensive [½]

Or insurance [½]

incentive exercises [½]

scheme design [½]

If the trustee is concerned about benefit security in the short term, and feels that the employer is not being collaborative (eg not providing appropriate information needed for trustee decision making purposes), it could seek the assistance of a Pension Regulator [½]

[Max 7]

vi) Assuming no change to the investment strategy, may want to be more prudent in funding strategy [½]

This is very difficult to do in an objective way and relies on the actuary using judgement based on previous experience and a consistent application of the approach used to derive the prudence margin in the first place [½]

However, it is likely that the trustees will change the investment strategy to one with lower risks (eg more bonds and fewer equities) [½]

The lower risk nature of these assets means that the prudence margin applied by the actuary is of less significance [½]

But it will still be necessary to apply a margin for prudence (eg in relation to the default risk of corporate bonds) [½]

And similar challenges of objectivity/consistency to those set out above apply [½]

In practice, these changes can be very contentious given the significance of the issues for both the company and the trustee [½]

Any amendment to the deficit contributions/recovery plan is likely to involve the external covenant assessor just as much as the actuar [½]

Although projections of the funding position into the future remain the preserve of the actuary [½]

Will need to update solvency position [½]

And assess benefits available on insolvency [½]

E.g. does a central discontinuance fund exist? [½]

[Max 4]
[Total 30]

(i) Many candidates went into too much detail in this part which dealt with principles so, although most people got good marks, it took some of them a lot longer to get them because they included too much detail which had a tendency to obscure the key principles.

(ii) Quite a few people got side tracked in this question by giving a lot of detail about setting prudent funding bases when the focus of the question was how to take account of the covenant in funding advice.

(iii) Most candidates got full or almost full marks for this question but they included quite a few extraneous invitees along the way who would either be unlikely to be able to contribute much to the primary meeting purpose, or suggested a much more serious situation for the scheme than had at that point been determined.

(iv) Most candidates scored well in this part but some seemed to struggle with the difference between investigations in this part and the resulting actions in part (v). This led some to miss out obvious investigations.

(v) This part was answered reasonably well but some candidates seemed to focus unduly on 'nuclear options' such as winding up the scheme without seeming to understand or consider which situations might make this a sensible course of action - eg how much the share price reduction actually affected the ability of the sponsor to continue to support the scheme.

(vi) There was a wide range of success on this part but some candidates seemed not to appreciate which advice the actuary would provide and which would be provided by other advisors such as investment advisors.

Q3(i) close the scheme to new entrants [½]

the employer would need to set up a different scheme with lower financial risk, which could be on a defined contribution basis [½]

close the scheme to future accrual [½]

could reduce accrued benefits [½]

any example of reducing future benefits will reduce risk as well as cost (just 1 example to score) [½]

move to shared cost scheme [½]

again the employer could offer an alternative scheme for future service benefits [½]

which could depend on legislation [½]

propose changes to the investment strategy such as switching to assets which more closely match the underlying liabilities (such as bonds) [½]

or proposing a mechanism to switch when certain trigger conditions are met [½]

or securing some of the benefits with an insurance policy (eg pensioner buy-in) [½]

or investing in assets which are negatively correlated to likely employer financial performance [½]

or suggesting that growth assets are invested in diversified asset classes (eg equity, property, hedge funds, other alternatives) [½]

or suggesting that equity options are used to restrict the downside of a potential equity market crash [½]

or longevity insurance [½]

the employer could propose that incentives are offered to members to transfer out their benefits from the scheme [½]

although such an exercise would need to take in to account the any guidance that applies to incentive exercises [½]

the employer could propose that members have the option to convert 'hard to insure' indexed benefits to higher flat benefits as a further retirement option [½]

the employer could propose that higher cash commutation rates are offered to encourage members to take the full tax free cash sum at retirement [½]

the employer could propose that a full transfer of benefits is made available at retirement (noting there is no statutory entitlement) [½]

and finance the cost of advice to encourage members to engage and make informed decisions [½]

the employer could offer full commutation of benefits as allowed [½]

the employer could look to insure risk benefits [½]

such as death in service lump sums [½]

or spouses' pensions (possibly insuring a sum intended to be an approximate cost of the benefit) [½]

the employer could appoint scheme managers/trustees that are experienced in matters of financial risk management [½]

could invest in more matching/income generating assets [½]

to ensure that the scheme is governed in accordance with risk management best practice [½]

[Max 10]

(ii) group life assurance is used to insure death in service benefits [½]

individual immediate annuities used to secure a pension once it becomes payable but remaining an asset of the scheme [½]

bulk immediate annuities used to secure pensions for a number of pensions that are already in payment and remaining an asset of the scheme [½]

individual or bulk immediate annuities bought out in the name of the member [½]

non-profit deferred annuity (similar varieties as for immediate annuities listed above) but relating to pensions that are not yet in payment [½]

medically underwritten immediate annuities (designed to reflect the actual state of health of the member) [½] note the annuities may not offer a precise match to the benefits payable by the scheme (in which case the scheme would underwrite any negative balance and may profit from any positive balance) [½]

longevity swap (designed to protect against adverse mortality experience) [½]

note much of the mortality risk is likely to be reinsured to one or more reinsurers [½]

insurance against sponsor default [½]

credit default swaps [½]

indemnity insurance for the scheme managers/trustees [½]

offering protection to managers/trustees against risks such as failing to pay correct benefits, data breaches as a result of a cyber-attack, and asset misappropriations [½]

[Max 5]

(iii) Note that annuities would be used (rather than insurance based investments or longevity swaps) to meet the employer objective for pension benefits [1]

Including non-profit deferred annuities to cover deferred pensions [½]

And group life insurance would be used to meet death in service benefits [1]

Including the full insurance of the spouse's death in service pension [½]

And any other death in service pensions (eg other dependants including children) [½]

(iv)

<u>Use of annuities – buy out</u>

the member is guaranteed to receive the pension as long as the insurer remains solvent [½]

and this is the case for both immediate and deferred annuities [½]
if the insurer defaults, the member may receive compensation (eg in the UK they will receive limited compensation from the FSCS [½]
the benefit will be paid by the administrator used by the insurer [½]
there will be no opportunity to benefit from any discretionary increases awarded to pensioners [½]

security for remaining members could be reduced [½]

regulation of the contract may transfer to a different regulatory body (for example in the UK this will be from tPR to FCA) [½]

loss of communication with members [½]

the member may have no redress via mechanisms available in the scheme (for example, in the UK, IDRP or the Pension Ombudsman) [½]

<u>Use of annuities – buy in</u>

if the insurer defaults, the scheme will remain liable for the underlying pension [½]

this is sometimes seen as offering double insolvency protection (although if the employer defaults, the proceeds of the insurance contract may fall back to the general assets of the trust) [½]

the pension may still be considered for future discretionary increases [½]

although this could mean that the benefit was paid by different administrators [½]

unless the discretionary increase was secured with the same insurer used for the primary benefit [½]

the member remains a member of the scheme and enjoys the protections that the work based pension scheme regulatory environment provides [½]

in the UK this includes participating in the Pension Protection Fund if the employer defaults and the scheme meets the eligibility requirements [½]

note that non-profit deferred annuities are very expensive so their purchase is likely to adversely impact the funding position of the scheme [½]

potentially this could put some of the benefit at risk if the employer is unable to finance the deficit created by the annuity purchase [½]

<u>Use of group life assurance</u>

use of such insurance provides additional certainty that the benefit will be paid [½]

for example, particularly in smaller schemes, the strain associated with a catastrophic event might render full benefit payments unaffordable [½]

in which case, in the UK, the scheme would transfer to the Pension Protection Fund and benefits secured based on PPF priorities [½]

the insurer will not face liquidity issues to meet a large claim (or series of claims) which could be a constraint for a scheme (meaning that payment of the benefit is likely to be prompt) [½]

there is no implication on the discretionary nature of the payment – even if insurance is used, the scheme’s managers will be able to direct the payment based on an expression of wish form completed by the member [½]

the spouses death in service pension is likely to be paid directly by the insurer used to insure the benefit [½]

since they will be pricing the contract based on their own assessment of the cost of the benefit [½]

so many of the points covered in the immediate annuity section above apply to the spouses death in service pension [½]

<u>Indemnity insurance for scheme managers</u>

the employer would receive second order protection from the use of such insurance since the scheme managers may not have the means to make good uninsured losses

[Max 15]

(v) prior to the decision to use insurance, the funding advice is likely to have included an estimate of the accrued cost [½]

which may have been on pro-rata service related basis [½]

and an associated reserve included in the past service cost [½]

and an allowance for the cost of accrual [½]

based on the expected cost of the benefit (using the scheme mortality assumption) [½]

but allowing appropriately for the release of the past service reserve to meet the past service element of the cost [½]

which would have been included in the standard contribution rate for the scheme [½]

the basis used for the calculation would have to be set prudently [½]

with an insurance contract, it is likely that the actual cost of the insurance will be used as the annual cost [½]

so any reserve in respect of the accrued liability would be released [½]

and the overall impact on the contributions payable by the employer will depend on how the profit generated by the release will be adopted in the contribution rate [½]

as well as how the actual cost of the insurance compares to the future service cost being used for funding purposes [½]
could be funding gain or loss depending on the assumptions used previously [½]

[Max 5]
[Total 35]

(i) Few candidates scored really well in this part and this was often due to them considering all employer risks rather than just the financial ones. However, there was also a tendency to go into too much detail about some actions (such as reducing the ongoing cost of accrual) and not think widely enough about the whole range of options.

(ii) Most candidates scored reasonably well on this part, only the better candidates thought more widely and scored very well. Many included income protection policies as a potential insurance for the scheme without recognising that this would be an additional benefit unless it was only to provide ill health retirement benefits.

(iii) This was one of the most challenging parts to the paper which many candidates struggled to score highly on. This was mostly due to looking at the impact from a scheme perspective rather than a member perspective, seeming not to be aware of the practical aspects of buy-ins and buy-outs and not thinking widely enough about possible implications.

(iv) Again this was a challenging part to the paper. Many candidates discussed the impact on the scheme of providing the benefit rather than the impact on the funding advice of insuring the benefit.

[Paper Total 100]

END OF EXAMINERS' REPORT

