INSTITUTE AND FACULTY OF ACTUARIES

EXAMINERS’ REPORT

September 2021

SP4 – Pensions and Other Benefits Specialist Principles

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.

Sarah Hutchinson
Chair of the Board of Examiners
December 2021

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

The aim of the Pensions and Other Benefits Specialist Principles subject is to instill in successful candidates the ability to apply, in simple situations, the mathematical and economic techniques and the principles of actuarial planning and control needed for the operation on sound financial lines of providers of pensions or other employee benefits.

This subject examines the ability of candidates to apply core actuarial techniques and concepts, together with specific knowledge of pensions and other benefit arrangements to simple, but practical situations.

The Examiners therefore look for candidates to apply their knowledge of the Core Reading to the specific situation that the Examiners asked, having read the question carefully. Many candidates write around the subject matter of the question in more general fashion, or focus on one aspect of the issue at great length, in either case gaining few of the marks available.

Good candidates demonstrate that they have used their time well - an attempt to get a logical flow is a big advantage in making points clearly and without repetition. This also 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. Candidates who give well-reasoned points, not in the marking schedule, are awarded marks for doing so.

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

In comparison to recent diets of the SP4 examination, a larger proportion of candidates passed. Since April 2020, this examination has been taken online, so the performance in this examination may not be directly comparable with examination diets before this date. This was a well-balanced exam paper and well prepared candidates were able to score well and pass. The pass mark of 62, reflects the performance of a minimally competent candidate.

It is very important that candidates consider all aspects of the question, and read the introduction fully. By using all of the information available, candidates can ensure they give a full answer. Giving just a little more to clearly show depth can turn a close fail into a pass. 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.

The questions that were least well answered in this paper were questions Question 5(ii) relating to changes in funding position and Question 6(ii), (iii) and (iv) relating to aspects of sponsor covenant. These were application and higher order skills questions and candidates generally lacked the breadth and depth of response required to score highly in these questions.

Candidates are reminded to study the whole syllabus as all areas may be tested. Candidates are reminded to pay attention to the command verbs and practice these types of questions as part of their preparation. A list of what is expected for each command verb is available on the IFoA website.

C. Pass Mark

The Pass Mark for this exam was 62
172 presented themselves and 96 passed.

Solutions for Subject SP4 – September 2021

Q1
(i)
General comments
The actual cost depends on actual experience of scheme and membership [½]
Financing methods only affect the pace of funding [½]
Regulations may restrict the method of financing [½]
e.g. requiring adequate security of benefits at the point the member joins which is reflected in the use of this method [½]

Specific comments
This method can be durable e.g. if the scheme closes to new entrants further contributions may not be required [½]
It can provide a realistic cost of pension provision if the assumptions used are best estimate and are borne out [½]
However, there is little flexibility in timing of contributions [½]
And this can cause liquidity issues for the company [½]
There is also a large opportunity cost [½]
especially if members leave the company before expected as lump sum could be locked in under the assets of the scheme [½]
UK Companies which sponsor defined benefit schemes usually opt for financing through regular contributions to avoid this [½]
This method could lead to overfunding which, if there are tax concessions, may lead to financial penalties by a State concerned with tax abuse [½]
Pension scheme managers may favour this approach because it provides good security [½]
but large payments may impact on the sponsor covenant [½]
The lump sum made may not cover the full / actual cost of benefits [½]
as based on assumptions [½]
Contributions made will fluctuate over time, depending on the level of benefits expected and new entrant characteristics [½]
and therefore may not be stable [½]
e.g. expected cost of benefits for a director would be higher than for a junior staff member [½]
would expect more stability in a larger scheme or where new joiners occur more regularly [½]
[Marks available 10, maximum 6]

(ii)
Reasons for a review of the scheme's investment strategy:
There has been a recently completed an actuarial funding valuation or periodic actuarial review [½]
Change in sponsor covenant [½]

An appropriate interval for review has passed so it is now due – e.g. good governance or regulations may require periodic review [½]
The liability profile has changed significantly since the previous review e.g. due to scheme closure or legislative changes [½]
The funding position has changed significantly, particularly if due to poor investment experience [½]
The investment manager's performance is out of line to expected e.g. fees or performance [½]
There is a new asset class available (could either be due to a change in the market or a change in scheme size) or the expectation of market returns changes [½]
Legislation or guidance changes affecting permitted investments or investment strategy [½]
The managers' risk appetite has changed [½]
Funding target may have changed, e.g. the trustees intend to buy out pensioners with an insurance company [½]
Cashflow requirements have changed, more or less liquidity needed [½]
Desire to allow for environmental, social and governance considerations [½]
The sponsoring company has requested that the managers review the investment strategy [½]
There has been a change in member behaviour or option terms (TVs, cash) requiring more liquidity [½]
A liability management exercise is due to take place, which is expected to impact the liability profile and/or liquidity requirements [½]

[Marks available 7½, maximum 5]

[Total 11]

Part (i) was generally well answered with better prepared candidates providing a broad range of comments and scoring well.

Part (ii) was generally very well answered.

Q2

(i)

Direct provision:
The government might provide the benefit directly [½]
or offer lump sum to all affected citizens [½]
maybe subject to a cap [½]
or a means test i.e. offer only to those with wealth / income under a specified threshold [½]
however people may hide wealth /income to ensure they are eligible for the benefit [½]
Provision may require an increase in taxes [½]
which citizens may not appreciate [½]

Compel:
The government could compel companies to offer a benefit [½]
partially subsidising e.g. through tax incentives [½]
Companies may feel that such benefit may not be relevant if citizens have retired by age 70 [½]
The benefit could be standalone or part of pension scheme being offered to members [½]

Compel citizens to save for their own funeral costs [½]
e.g. compel to take an insurance product covering this [½]

Educate:
The government could educate citizens on the importance of to saving for funeral costs [½]

Encourage:
Government could legislate to auto-enrol employees into their employers' plans [½]
Government could regulate providers of funeral savings plans to ensure confidence in the system [½]
Government could facilitate saving with a government funeral savings plan [½]
or provide tax breaks for those that do [½]
Government could require funeral directors to provide a basic, low-cost funeral [½]
or set caps on the cost of basic funerals [½]
[Marks available 10, maximum 6]

(ii)
Factors that may give rise to an actuary giving inappropriate advice:
incompetence or insufficient experience of the actuary [½]
lack of integrity of the actuary [½]
the use of an unsuitable model or parameters [½]
errors in the data relating to the beneficiaries or errors in calculations [½]
investment or benefit provider switches where administrative expense involved in switching outweighs the benefits of switching from having what may well be better investment, provider or form of provision [½]
actuary misinterprets information received or misunderstands client instruction [½]
conflicts of interest [½]
inappropriate or insufficient legislation and/or guidance [½]
[Marks available 4, maximum 2]

(iii)
Examples of policies – capped at 1 mark for each factor
Incompetence / insufficient experience of actuary:
Require professional qualification [½]
and regulation by a Professional Body [½]
Require the advisor to have a sufficient length of experience [½]
Ensure advice is peer reviewed by another actuary of suitable experience [½]
Government, or suitable governing body, to periodically review the work performed by actuaries [½]
Require ongoing program of continued professional development [½]

Lack of integrity of actuary:
Regulate advisors and their dealings with clients [½]
Issue fines for advisors who try breach rules [½]
Require actuaries to be struck off for serious issues [½]
Require whistle-blowing [½]

Manage conflicts of interests:
Require conflicts to be disclosed [½]

Require actuaries to resign / step back from projects where they are conflicted [½]
Put in place ethical walls [½]

Unsuitable models/ parameters:
Enforce models to be peer reviewed by a suitable actuary [½]
Enforce actuaries to set out limitations of the model [½]
including the parameters used [½]
Require illustrations of sensitivity to models / parameters [½]

Errors in the data relating to beneficiaries or errors in calculations:
Ensure actuaries set out the data being used in their reporting so errors might be picked up [½]
Ensure appropriate data checks are carried out on the data [½]
Require checking / peer review of work [½]

Investment switches where expenses outweigh benefits:
Enforce risks of switching and expected return to be clearly set out in advice [½]
Enforce advisors to have specialist qualifications for advising on investment switches [½]

Inappropriate or insufficient legislation and/or guidance:
Review legislation / guidance frequently as fit for purpose [½]
Monitor / police professional bodies [½]
Consult with key stakeholders regularly [½]

Actuary misinterprets information received or misunderstands client instruction:
Actuary to ensure information and instructions received are unambiguous [½]
Actuary to ensure communication with the client, including scoping and reporting, is clear [½]
[Marks available 8, maximum 4]

(iv)
Managers should:
Ensure the security of benefits in the scheme [½]
Managers act in the interest of all members [½]
ensuring to take account of aspects relevant to each membership category - treat all fairly [½]
ensuring they are aware of the potential conflicts with their role within the company for example as finance director [½]
or also as a member of the scheme [½]
Not to profit from duties [½]
Administer the benefits [½]
or delegate to specialists – appointing appropriate advisers [½]
Seek advice where relevant [½]
e.g. actuarial and legal [½]
but ensure that scheme doesn't pay undue costs [½]
Act in accordance with Rules of scheme [½]
and with legislation / professional guidance [½]
Consider any professional guidance [½]
Ensure assets are invested appropriately [½]

including setting out a formal policy on investment strategy [½]
Hold regular meetings [½]
taking and keeping meeting notes for records [½]
Maintain confidentiality [½]
including how they feedback information to the company for example as finance director [½]
Execute discretion where required [½]
e.g. with benefit payments or pension increases [½]
Consider the security of the scheme such that there are sufficient funds to meet the benefits as they fall due [½]
Seek and monitor sponsor financial support [½]
monitoring covenant [½]
meeting with sponsor regularly, as a manager rather than for example as finance director [½]
Monitor funding levels [½]
obtaining regular actuarial valuations [½]
agree contribution rate with the sponsor [½]
noting their role as finance director may mean they are excluded from such discussions [½]
Suitable training on becoming a pension scheme manager / including any relevant qualifications [½]

[Marks available 15½, maximum 8]

[Total 20]

Generally this question was well answered. In particular candidates were able to provide a broad answers to part (iv) to score well.

Q3

(i)

Examples of policies - capped at 1 mark for each factor

Fixed percentage increase in benefits:
Fixed percentage increase in value of benefits assuming the member remains in employment until normal retirement age [½]
e.g. 10% increase in value, converted to a pension on retirement [½]
Percentage increase in value, with the percentage based on the member's length of employment [½]
e.g. 1% increase for each complete year of employment, converted to a pension on retirement [½]
could be capped to a maximum number of years [½]

Fixed amount of increase:
Fixed amount increase in value, converted to a pension on retirement - give example [½]
Fixed for all members, based on member's length of employment or role level/function - give example
e.g. £1,000 p.a. for each year of service [½]
Added years - e.g. one month added for each complete year worked [½]
No reduction on early payment - e.g. no early retirement factors for retirement after age 60 [½]

Increase or waiver of any caps relating to pay or service - e.g. increase salary cap by 10% [½]

Additional service:
Benefits could be calculated allowing for (some of) future prospective service to NRA [½]
This could be particularly generous for younger members [½]
It may allow older members to be able to retire and not seek work with competitors [½]
[Marks available 6½, maximum 2]

(ii)
Issues for the Company to consider when setting enhancement terms:
The objectives of the company, for example [½]
if they are seeking voluntary redundancies, they want the terms to be sufficiently generous to encourage appropriate take up [½]
if they will be making forced redundancies, they may want to consider the impact the terms might have on the actions of the remaining workforce [½]
The impact of the terms on cost and contributions [½]
The number of members who the company are planning to make redundant [½]
and their value of benefits [½]
Who will meet the cost of the enhancement [½]
either scheme or company [½]
Potential funding impact on the scheme from the enhanced benefits if enhancement made from the scheme assets [½]
leading to increased contributions to the scheme from the company [½]
and the timing of those increased contributions - immediate payment or swept up with next valuation? [½]
or alternatively the cost of the enhancement if paid for directly by the company [½]
Both approaches having an opportunity cost [½]
and potential liquidity issues [½]
Accounting impact [½]
Enhancement could be linked to market movements [½]
The method and basis used to set the terms [½]
e.g. the use of the (prudent) funding basis may lead to higher costs / contributions than the use of a best-estimate basis [½]
e.g. the use of a market-related basis which could lead to inconsistent enhancements over time [½]
Potential industrial relations impact on the workforce who remain in employment from enhancement provided to employees who are made redundant [½]
Pension scheme managers may need to be consulted [½]
Legislation may restrict or stipulate enhancement options [½]
Or scheme rules may specify enhancement [½]
Consider the viewpoint of the scheme managers or Trustees, [½]
such as fairness across members and security of benefits [½]
Consider consistency with previous redundancy exercises [½]
and any precedent which may be being set [½]
Seek actuarial and legal advice [½]
Consider practical issues and costs [½]
e.g. in communicating and running the enhancement [½]
[Marks available 15, maximum 7]

[Total 9]

Part (i) was generally not well answered and many candidates failed to provide two distinct methods of increasing benefits.

Candidates performed better in Part (ii) although some candidates provided many points relevant to Trustees, whereas the question specifically asked for the Company viewpoint.

Q4

(i)

Model should be able to allow for each individual's characteristics [½]

Data needed:
investment strategy / asset allocation [½]
both for invested assets and future contributions [½]
future contributions, for example will this individual continue to pay 10% of salary each year [½]
charges for assets under management [½]
current fund value [½]

Assumptions:
illustrating variability is important, stochastic rather than deterministic might be better [½]
assume no pre retirement mortality over the 20 years to age 65 [½]
assume no withdrawal over the 20 years to age 65 [½]
investment return, net of fees for each fund [½]
assume contributions continue at current percentage of salary [½]
salary growth assumption [½]
assume no changes to investment strategy, other than life styling if in default fund [½]
assume no changes to the allocation of the individual's future contributions to their chosen investment funds [½]

The model would:
project cashflows (contributions and investment income) and accumulate these to age 65 [½]
accumulate the current invested fund to age 65 [½]
sum these to give a total accumulated fund at age 65 [½]
use different scenarios or stochastic approach [½]
provide a range of outputs - show distribution of outcomes for pot size [½]
consider presenting the results in real terms, in which case need inflation assumption [½]
consider allowing parameterisation to allow the model to illustrate the impact of increasing contributions or changing investment strategy [½]

[Marks available 10½, maximum 6]

(ii)

Annuity:
provides guaranteed income for life [½]
but no inheritance if life is cut short [½]

although some annuities offer a guarantee that they will pay out a minimum number of years of payment [½]
may be able to access better terms if life expectancy is reduced [½]
can purchase level or increasing annuity [½]
and with or without a spouse's or dependent's pension on death [½]
usually purchased with an insurance company which is likely to have a strong covenant [½]

Drawdown:
pot remains invested [½]
individual continues to be able to manage their investments, e.g. fund changes [½]
individual draws down funds when required [½]
the pot may be converted to an annuity later [½]
if individual dies early, remaining pot can be passed to dependants [½]
there is a risk that funds run out [½]

[Marks available 6½, maximum 3]

(iii)
Considerations for the member:
life expectancy [½]
consider the ill-health condition [½]
is it life limiting? Can the member live a long life, is potentially expensive medical or nursing care needed? [½]
an annuity provides guaranteed income and may be good value for those expecting to have a long life [½]
consider value of impaired life annuity (if available) versus ability to drawdown greater funds whilst living and pass remaining pot to dependants on death [½]
the current annuity market: annuities may be expensive as the insurer needs to cover the profitability and expenses requirements [½]
although good competition in the market will reduce the cost [½]
financial knowledge / access to advice [½]
drawdown needs to be regularly monitored and requires a degree of financial sophistication or advice [½]
drawdown requires ongoing investment input so again some knowledge of investments, persisting as long as the drawdown is being used this may be a particular issue if illness may cause a reduction in mental capacity in later years [½]
decision regarding how long to drawdown and at what age to annuitise is not straightforward [½]
particularly as the member will suffer mortality drag on annuitisation [½]
consider information asymmetry between individual and provider about their ill health status [½]
desire to leave an inheritance [½]
if don't take an annuity remaining pot can be passed onto dependants. [½]
amount of income required [½]
if member has other sources of income, this decision may not be as important [½]
shape of income required [½]
drawdown gives the member the flexibility to access varying levels of income in retirement, depending on requirements, and may be more suitable if a non-level or steadily increasing amount is required [½]
cost of administration [½]

The costs of administering the drawdown arrangement may be high [½]
annuitisation has no ongoing costs [½]
dependants benefits [½]
could provide a dependants benefits via an annuity [½]
or pass the remaining drawdown fund on death [½]
The remaining fund on the member's death may be insufficient to provide adequate benefits for a dependant [½]
risk appetite [½]
annuities provide guaranteed income for life [½]
with drawdown, if only the income earned on the fund is taken each year the member's income could be volatile [½]
but if a fixed income is taken the capital could potentially reduce to zero before the member dies leaving the member dependent on the state at the end of his or her life [½]
consider views on security of insurance company providing annuities versus the drawdown provider [½]
consider the compensation funds available to, the annuity and income drawdown providers [½]
tax charges [½]
There may be a tax charge on the residual fund on the member's death [½]
The tax status of income from annuities and income drawdown may differ [½]
pot size [½]
A pot of $450,000 should be sufficient for either option [½]

Value for money:
annuity market be unfavourable, may do drawdown for period until terms change [½]

[Marks available 19, maximum 8]

[Total 17]

This question was generally very well answered and many candidates scored well, particularly on parts (ii) and (iii).

Candidates who structured their answer clearly on part (i) scored better than those who didn't.

Q5

(i)

Information from previous actuarial advisor:
Previous funding valuation report [½]
including agreed contribution rates (if applicable) [½]
method and assumptions [½]
funding objectives [½]
and strength of sponsor covenant allowed for [½]
any correspondence with the regulator [½]
extent to which discretionary practices were allowed for in the valuation [½]
Details of any funding advice provided following the valuation [½]
Details of any funding concerns [½]

Information from managers:
Rules of scheme X [½]
stating the benefits promised under the scheme [½]
Special member letters [½]
as some executive members may have had special benefit terms offered to them under discretion [½]
Details of any past and current discretionary practices [½]
Views on any future discretionary practices [½]
or changes to benefit entitlements [½]
Managers' view of the strength of the sponsor covenant [½]
Market value of assets at the valuation date [½]
including formal report and accounts [½]
Individual membership data [½]
split by member category [½]
including data such as gender, date of birth, normal retirement age/date, date joined scheme [Maximum 2 examples - ½ each]

but being mindful not to request personal / sensitive data [½]
Membership data used in previous actuarial valuation [½]
to reconcile and check against (or to replicate last valuation results) [½]
Details of any insured policies (if applicable) [½]
Scheme factors for valuing an options [½]
Details of scheme's investment strategy [½]
Minutes of meetings [½]
Details of scheme experience to help set assumptions [½]
[Marks available 15½, maximum 9]

(ii)
Introductory points:
The funding level of Scheme A is similar to the last valuation (120% to 118%) but the funding level of Scheme X has deteriorated (45% to 23%) [½]
This may reflect good matching of the assets and liabilities in Scheme A [½]
and poor matching in Scheme X [½]
Assets in Scheme X has increased by a bigger percentage (120%) than Scheme A (108%) [½]
which might reflect the higher contributions (including deficit contributions) paid [½]
Liabilities in Scheme X more than doubled (236%) whereas the liabilities in Scheme A increased similarly to the assets (110%) [½]

Further potential reasons:
Error in how data / benefits interpreted in valuing liabilities [½]
Data provided may be incorrect / different [½]
Previous valuation may have used a weaker funding basis [½]
e.g. closer to a transfer value basis [½]
whereas using a more stronger basis here per scheme A [½]
Change in funding method from that used in previous valuation [½]
to a method which generates surplus [½]
Scheme X may be open to future accrual of benefits and/or new joiners [½]
which increases the liability, significantly so in an immature executive scheme [½]

Increase in liability due to interest applied [½]
Benefits in scheme X different to those in Scheme A [½]
e.g. more inflation linked benefits in scheme X [½]
and inflation expectation is much higher [½]
or legislation changes impacting Scheme X but not A [½]
or benefit improvement / augmentation valued in Scheme X [½]
change in discretionary benefits offered under Scheme X [½]
Scheme X, Execs may have had a large increase in pensionable salary or benefit improvements, increasing the liabilities [½]
Market conditions different between those at previous valuation and this valuation date [½]
Assets performed worse than expected compared to liabilities [½]
Assets may be valued differently between each scheme [½]
e.g. market value or discounted cashflows [½]
Contributions paid by sponsoring company over inter-valuation period lower than required for Scheme X [½]
Movement in members different in scheme X vs scheme A [½]
especially if the maturity of each scheme is different [½]
and the potential small size / large liability values for members of Scheme X may mean that membership changes have significant impact on the liabilities [½]
e.g. if the CEO recently early retired on generous terms [½]
High salary increases than expected in Scheme X (if a final salary scheme) [½]
Lower post-retirement mortality in Scheme X than expected [½]
New assumptions better reflect characteristics of Scheme X [½]
e.g. higher salary growth and lower mortality for executives [½]

[Marks available 18, maximum 10]

[Total 19]

Part (i) was generally well answered.

Part (ii) was less well answered with many candidates struggling to provide a broad range of reasons for the difference in funding position. Better prepared candidates were able to provide a breath and depth in their response. Many candidates did not consider that Scheme X was an executive scheme. Using this knowledge allowed candidates to tailor their answer and generate further points.

Q6

(i)

Sponsor covenant should be considered when the reliance on the sponsor for support and contributions is uncertain [½]
and that such support will be relied upon in the future [½]
Sponsor covenant should be considered in all circumstances besides the scheme being very well funded, so no reliance on sponsor [½]
or strong enough to be deemed certain [½]
or so weak is deemed nil [½]
or sponsor has no further liability [½]

[Marks available 3, maximum 2]

(ii)
Implications of accepting the temporary reduction in deficit reduction contributions:
It negatively impacts security of the benefits [½]
especially if scheme has large deficit [½]
and contributions were large relative to size of scheme and deficit [½]
depending on size of reduction relative to contributions being paid [½]
the strength of the basis used to calculate the contributions [½]
and period of time over which the reduction is applied [½]
impact depends on company's proposal for making up the contributions [½]
do they intend to put in place a longer deficit recovery period? [½]
or pay higher contributions once the temporary period has elapsed? [½]
Managers may be less concerned if their funding approach is very prudent than if more optimistic assumptions were used [½]
Managers need to consider the potential impact on members benefits if deficit contributions are reduced and the company fails [½]
how much more would benefits be reduced? [½]
is there a CDF which will provide a safety net? [½]
Managers need to understand the potential impact on members benefits if the company is strengthened via the restructure [½]
will benefits be improved [½]
The managers may need to notify a regulator who may become involved [½]
The managers should take actuarial and legal advice [½]
Managers may need to revisit investment strategy [½]
And funding strategy - may want to get an updated valuation position [½]
Could potentially impact the cashflow of the scheme [½]
as deficit reduction contributions may be used towards paying benefits [½]
if the income from the investments and contributions for future service are not sufficient for these [½]
so requires disinvestments from the invested assets [½]
thereby reducing expected investment returns [½]
Could be a breach of the agreement made at the previous valuation or when contributions were agreed [½]
Could be considered a weakening of the sponsor covenant [½]
so trustees may want to commission a new valuation to assess the funding impact [½]
but the temporary reduction may help the sponsor get into a better financial position [½]
and may help protect the jobs of for the scheme members [½]
and ensure the scheme is affordable for the sponsor and help avoid insolvency and ensure ongoing sponsor support for the scheme [½]
protecting members benefits which may be reduced on insolvency [½]
and allowing members to continue to accrue benefits [½]
accepting the request may help strengthen the sponsor covenant in the longer term [½]
but less so as future accrual of benefits is retained [½]
Perhaps seen by members as not as paternal [½]
may think closure to accrual is due [½]
Members may feel that employee contributions for future benefits may increase/commence to retain future accrual of benefits [½]
Company may not be able to benefit from any tax concessions they were receiving from paying the higher contributions [½]
Consider the views of any regulator to ensure that managers fulfil their duties [½]

[Marks available 19½, maximum 8]

(iii)
Credit the best 4 from the list below, capped at 2 marks each
Request for guarantee [½]
if manufacturing company has a parent company [½]
and depending on financial strength of the parent [½]
with a guarantee up to an agreed amount [½]
possibly at least the amount of contributions not paid into the scheme [½]

Fixed charge on company assets [½]
such as property or manufacturing equipment [½]
where become under scheme ownership if the company was to become insolvent [½]
and expect value of assets under charge to bridge a potential deficit in the scheme [½]

Ratchets on contributions back to original level [½]
when company financial position improves to agreed position [½]
agreed level of contributions depending on company financial position [½]
including contributions paid back which were suspended [½]

Put in place restrictive covenants [½]
which restricts the company from undertaking certain business activities [½]
especially whilst temporary reduction in contributions in place [½]
particularly around the funds which would ordinarily have been paid into the scheme being restricted [½]

Contingent contributions [½]
where additional contributions are due to be paid into the scheme when funding level fall below certain level [½]
or reduction ceases [½]
additional contributions due can be dependent on the level of change in the funding level [½]

Invest in a credit default swap [½]
which pays out if the company was to become insolvent [½]
potentially to a level which enables to scheme to bought out with an insurer [½]
or to a self-sufficient level [½]

Change investment strategy [½]
invest in more risk reducing assets and less in risk seeking assets [½]
e.g. bonds rather than equities [½]
to reduce the risk of the deficit becoming larger whilst contributions are temporarily suspended [½]
Use insurance policies [½]
such as buying-out the pensioner liabilities if it's advantageous to do so [½]

[Marks available 14, maximum 8]

(iv)
Implications of temporary suspension of transfer values:

Aids in cashflow management	[½]
especially if deficit reduction contributions are used for this purpose	[½]
Members taking transfer values would reduce the risks of the scheme	[½]
e.g. investment, inflation and mortality risks	[½]
so suspending transfer values would mean such risks are kept in the scheme	[½]
Transfer value basis usually weaker than funding basis	[½]
so no funding gain from members taking transfer values	[½]
and if TV decrement is included in valuation then lack of TVs will lead to a funding loss	[½]
could cause funding strain if TVs are taken whilst funding is poor and TVs are not reduced	[½]
Stops a potential group of members taking a transfer value if they feel the security of their benefits has reduced from the reduction in contributions	[½]
which would lead to liquidity issues	[½]
and advancement of their priorities which could be unfair to other members if the company fails and benefits are reduced	[½]
Removal of member option not appreciated by members / workforce	[½]
Leading to industrial action, possibly through unions	[½]
Paying transfer values can reduce the size of the scheme	[½]
which would have restricted invested options	[½]
so suspension of transfer values would retain broad size of scheme	[½]
Should consider legal implications (regulations and Trust Deed and Rules) – members may have a right to take a transfer value	[½]
May also reduce costs, saving the scheme / sponsor money on admin or actuarial fees	
but this might be reversed when TVs are permitted again	[½]
leading to administration bottleneck	[½]
and liquidity issues from influx of TV requests	[½]
Leads to inconsistency with other options which may be permitted such as cash commutation on retirement	[½]
A regulator may need to be notified who may become involved	[½]
Practical issues and costs; such as extra communication to explain the policy	[½]
but reduced administration in providing quotations and paying out TVs	[½]

[Marks available 12½, maximum 6]

[Total 24]

This question was, on average, not as well answered as other questions on the paper. This was mainly a straightforward question, and well prepared candidates should have encountered similar questions in their preparation for this examination.

Those candidates who planned well and had sufficient time to generate a broad range of points generally performed better on this question.

Part (i) was generally well answered.

Part (iii) required candidates to provide some detail on each arrangement to score full *marks. Most candidates were able to provide four different alternatives but few were able to generate enough points to score full marks.*

[Paper Total 100]

END OF EXAMINERS' REPORT

