EXAMINATION

23 April 2010 (pm)

Subject ST4 — Pensions and other Benefits Specialist Technical

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 before 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 all seven questions, beginning your answer to each question on a separate sheet.*

6. *Candidates should show calculations where this is appropriate.*

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 the 2002 edition of the Formulae and Tables and your own electronic calculator from the approved list.

1 A company that does not offer any retirement benefits to its employees provides a service that gives employees advice on how to provide for an income in retirement.

A 60 year old employee has recently received an inheritance of £200,000 currently invested in equity and property unit trusts. She has asked for advice on how to use this amount to fund for a retirement income from age 65. In particular she has asked whether she should use lifestyling.

(i) List the information that should be requested from the employee so that suitable advice can be given. [4]

(ii) Describe three options that could be considered to achieve an income in retirement, commenting where appropriate on the use of lifestyling. [4]
[Total 8]

2 A company sponsors a final salary pension scheme that provides benefits related to salary and service for most of its employees. A new Chief Executive Officer (CEO) is to be appointed and it is possible that the appointment will be made from within the company.

The Finance Director has proposed that, in respect of service as the CEO, the new CEO should be entitled to retire at any time between ages 50 and 60 with a member's pension of 50% of total earnings in the last year of service.

(i) Discuss how the company would mitigate any risks arising from this proposal. [8]

(ii) Suggest possible alternative approaches to the CEO's pension arrangements. [2]
[Total 10]

3 The government of a developing country which does not have a developed insurance market is proposing to offer its citizens a scheme under which they pay a contribution each month which entitles them to a flat rate lump sum benefit on death before a specified age.

(i) Outline the analysis that should be carried out to investigate whether to implement this proposal. [3]

(ii) List the factors that should be taken into account in setting the level of contribution. [3]

(iii) Discuss the practical issues that may arise and how they might be overcome. [6]
[Total 12]

4 The trustees of a defined benefit pension scheme are planning to assess the strength of the sponsoring employer’s covenant. One of the trustees is also the Finance Director and the other trustees have asked him to assess the employer’s covenant and to undertake the ongoing monitoring process on behalf of the trustees.

(i) Outline why the assessment of the employer covenant is important. [2]

(ii) Outline the key issues the Finance Director should consider in undertaking this task. [4]

(iii) List the information that could be used to assess the employer’s covenant. [4]

(iv) Outline the main features of the ongoing employer covenant monitoring process that the trustees should put in place. [2]
[Total 12]

5 A company provides a defined benefit pension scheme to its employees from age 65. The scheme rules state that the pension is subject to review annually.

In 8 of the past 10 years, the scheme assets together with lump sum payments from the company have permitted increases broadly in line with inflation to pensions in payment. However, following a period of recent deflation, the two most recent reviews resulted in no change in pension levels.

Scheme members have requested greater certainty over the way pensions in payment will be adjusted each year following the annual review. The company proposes to prepare a policy statement setting out how future reviews might be carried out and how these reviews would be funded.

(i) Discuss the items that might be included within such a statement. [9]

(ii) Discuss the advantages and disadvantages of making this statement available to scheme members. [5]
[Total 14]

6 The government of a developing country is setting up a State Pension scheme funded by contributions from employees and employers. It is considering whether benefits should be related to salary close to retirement or to salary averaged over an employee’s working lifetime.

(i) Set out the advantages and disadvantages to the government of the two alternatives. [11]

It is proposed to allow employers with existing pension arrangements to opt out of the State Pension scheme.

(ii) Discuss the criteria that could be taken into account when setting the terms for allowing employers to opt out of this new State Pension scheme. [4]
[Total 15]

7 Three years ago a manufacturing company closed all its defined benefit pension schemes to new entrants. For new employees joining since then the company has put in place a number of defined contribution pension arrangements which aim to target particular levels of benefits.

The decision to move towards defined contribution pension provision was driven by cost concerns. However the company is still concerned about its annual spend on pension arrangements as it is currently paying €10 million per annum towards the defined benefit pension schemes and €5 million per annum towards the defined contribution pension arrangements.

The company has approached an independent actuary and asked for advice on the options for controlling and reducing the costs of providing retirement benefits for its entire workforce.

(i) Outline the information that the actuary would require in order to provide this advice under the following headings:

(a) Employer information
(b) Scheme documentation
(c) Data

[10]

(ii) Outline the actions that could be considered as part of this exercise. [12]

(iii) Outline the practical difficulties the company could face when trying to reduce the cost of pension provision. [7]

[Total 29]

END OF PAPER