

INSTITUTE AND FACULTY OF ACTUARIES

EXAMINATION

20 April 2021 (am)

Subject SA4 – Pensions and Other Benefits Specialist Advanced

Time allowed: Three hours and fifteen minutes

<p>In addition to this paper you should have available the 2002 edition of the Formulae and Tables and your own electronic calculator.</p>
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If you encounter any issues during the examination please contact the Assessment Team on
T. 0044 (0) 1865 268 873.

1 XYZ Industries (XYZ) is a company that sponsors a large defined benefit pension scheme that is open to future service. The industry in which XYZ operates is experiencing an economic downturn and XYZ has decided to make significant redundancies from the workforce.

XYZ is expecting most of the redundancies to be voluntary, particularly where staff are able to take immediate retirement, but the scheme does NOT offer special early retirement terms for such staff who are made redundant. In the country in which XYZ operates, immediate retirement is permitted within 5 years of the State Pension Age.

XYZ's Finance Director has highlighted a scheme rule that permits members who retire before State Pension Age to opt for a bridging pension. In exchange for a lower pension overall, the bridging pension will provide a temporary uplift until State Pension Age. The uplift is calculated such that the total income the member receives from the scheme and the State remains unchanged when they reach State Pension Age.

- (i) Discuss briefly the risks and advantages, from XYZ's perspective, of encouraging eligible members to:
- (a) take early retirement on redundancy.
 - (b) take up the option of the bridging pension.

[8]

XYZ has now approached the trustees of the scheme and asked for their views on encouraging members to take up the bridging pension option, as part of the redundancy exercise.

- (ii) (a) Describe the information and guidance the trustees may seek. [5]
- (b) Outline the points they may make in their response. [2]

The trustees have asked their actuary to help them set out the requirements for offering and administering the bridging pension option.

- (iii) Suggest with reasons the points the actuary may make in response. [6]

XYZ and the scheme's trustees have agreed to proceed with offering the bridging pension option as part of the redundancy exercise and have included information about it in a communication to members setting out the terms for the voluntary redundancy. Members will be offered the opportunity to take financial advice paid for by XYZ.

- (iv) List the information the financial advisor should seek from members. [3]
- (v) Discuss the issues members should consider when deciding whether to opt for voluntary redundancy. [6]

[Total 30]

- 2 The trustees of a mature defined benefit pension scheme, which is open to accrual but closed to new members, are seeking to reduce the scheme's financial exposure to the performance of the sponsoring employer.

To help achieve this, they are considering buying out the scheme's benefits with an insurance company. The following results are from the most recent actuarial valuation of the scheme:

<i>Funding basis</i>	<i>Funding level (%)</i>	<i>Discount rate relative to the yield on government securities</i>
Ongoing	105	Approximately 1% p.a. above
Buy-out	85	Approximately 1% p.a. below

The trustees wish to effect a buy-out at an appropriate date in the future when they expect there to be no active members left in the scheme. To this end, they wish to set up strategies that develop over time to target a 100% funding level on a buy-out basis at that date.

The trustees have asked their actuary to produce a report to help them discuss appropriate strategies with a particular focus on:

- designing and choosing an appropriate mix of strategies.
- investment strategies.
- contribution strategies.
- implementation processes.

- (i) Set out the points the actuary should include in their report. [16]

The trustees are expecting to buy out all the scheme benefits and then close the scheme, but they are concerned about the likely cost of the buy-out, including insurance company premiums being relatively expensive. They have asked their actuary to identify four actions they may take in order to help reduce the cost.

The actuary has identified the following actions:

- cleaning the membership data
- converting pension increases
- removing or simplifying complex or difficult benefits
- enhanced transfer value exercise.

- (ii) Explain, for each action identified:

- the likely benefits.
- the likely costs.
- issues associated with the implementation.

[16]

- (iii) Suggest with reasons any other actions that would help keep costs down. [3]

[Total 35]

3 The government of a developed country is undertaking a fundamental review of its taxation and regulatory framework for pension provision to ensure this continues to meet its original objectives. These were to:

- provide appropriate support and encouragement of private pension provision.
- achieve a balance between State, corporate and individual pension provision.
- keep the total State cost arising from benefit payments and private provision incentives to a minimum.
- ensure a minimum standard of living for pensioners.

(i) List three ways that tax relief may be used by the State as part of a framework for pension provision, explaining for each how it may help meet these objectives. [9]

(ii) List two other high-level components that could be part of a framework for pension provision, explaining for each how it may help meet these objectives. [6]

Two details from the country's existing framework provide:

- for members to exchange part of their pensions for a tax-free lump sum at retirement.
- full tax relief on pension contributions from both sponsors and individuals.

However, the review has concluded that the government should implement the following two changes:

- Remove the tax concession when pensions are exchanged for lump sums.
- Introduce minimum contribution rates from both sponsors and individuals in order to qualify for tax relief on contributions.

(iii) Describe the expected impact of each of the changes above on pension provision and savings from the viewpoint of each of the following parties:

- (a) the State
- (b) sponsors
- (c) trustees/scheme managers
- (d) scheme members.

[20]

[Total 35]

END OF PAPER