

INSTITUTE AND FACULTY OF ACTUARIES

EXAMINATION

18 September 2023 (am)

Subject SA4 – Pensions and Other Benefits Specialist Advanced

Time allowed: Three hours and twenty minutes

In addition to this paper you should have available the 2002 edition of the Formulae and Tables and your own electronic calculator.

If you encounter any issues during the examination please contact the Assessment Team on T. 0044 (0) 1865 268 873.

1 An occupational pension scheme sponsored by the employer has two sections:

- A Defined Benefit (DB) section that is closed to both accrual and new entrants but has a continuing salary link for current employees
- A Defined Contribution (DC) section for the continuing accrual of DC benefits for members of the DB section, and for those joining the scheme after the DB section closed.

The scheme's trustees have traditionally sought to increase pensions in the DB section in line with inflation, but the legal framework for pension schemes has, for over 15 years, allowed them to cap annual increases in the DB section at 4%.

The last time that inflation exceeded the cap was 12 years ago. At that time, a valuation of the DB section, allowing for the cap, showed a deficit, and the trustees agreed to apply the cap to pension increases.

Inflation has now exceeded the cap again. However, a valuation of the DB section shows a surplus, which has arisen as a result of deficit contributions and investment returns.

The trustees wish to consult with the sponsoring employer on providing inflation protection for members' benefits in the DB section and are seeking advice from the scheme's actuary.

They have asked their actuary to:

- prepare a report covering the options for providing inflation protection along with the impact and implications of each.
- Draft a letter to the sponsor, on their behalf, setting out the trustees' rationale for providing inflation protection to benefits in the DB section.

(i) Set out:

- (a) the points the actuary may include in their report to the trustees. [12]
- (b) the points the actuary may include in the trustees' letter to the sponsor. [6]

The trustees send a proposal to the sponsor, suggesting that pensions in the DB section should be increased by the full rate of inflation. The sponsor, who is concerned that higher inflation is likely to result in pressure for higher salary increases, has asked their actuary to draft a response on their behalf.

(ii) Outline the points that the sponsor's actuary may include in the response. [7]

The trustees, having considered the sponsor's response, have decided to set pension increases in the DB section in line with inflation going forward.

(iii) Outline the impact this decision may have on:

- the funding strategy for the DB section.
- the investment strategy for the DB section.

[10]

[Total 35]

2 XYZ Enterprises (XYZ) sponsors a defined benefit pension scheme (the XYZ scheme) that provides the following benefits at retirement:

- A pension to the member
- A dependant's pension of 50% of the member's pension payable on the member's death
- The member may exchange (commute) part of their pension for a cash sum at retirement but the dependant's pension remains at 50% of the pre-commutation member's pension.

Following a recent funding valuation of the scheme, the XYZ scheme's trustees have decided to review the commutation factors.

(i) Discuss the considerations for the trustees in setting the new commutation factors, with particular reference to:

- the actuarial assumptions to be used.
- whether the factors should be fixed or market related.

[10]

Shortly before the date of the funding valuation, an enhanced transfer value exercise was undertaken for all the deferred pensioners of the scheme. XYZ was very pleased with the positive impact this had on the XYZ scheme's funding level and the reduction in risk that was achieved.

Currently the trustees provide retirement information packs to scheme members nearing retirement, detailing their benefits at retirement. XYZ has asked the trustees to include, in future information packs, the member's Cash Equivalent Transfer Value (CETV) of their scheme benefits, calculated without enhancement, using prevailing market conditions.

The trustees have asked their actuary to comment on whether, and to what extent, the actuarial assumptions used in determining the CETVs in the information packs may differ compared to those used for regular CETV requests from members.

(ii) Outline the points the actuary may make in their response. [5]

The trustees have agreed to the employer's request to include CETVs in future retirement information packs. They have asked their actuary for advice on what additional information to include in the retirement packs in addition to a statement of retirement benefits and the CETV.

(iii) Outline, with reasons, the points the actuary may include in their response. [5]

Market interest rates have recently fallen such that CETVs give rise to a much greater value of benefits than the commutation factors. A scheme member who has recently received their retirement information pack has written to the trustees for an explanation of why this is the case.

(iv) Outline the points the trustees may include in their response. [5]

The member has engaged a financial advisor to assist them with their retirement planning.

- (v) List the information that the financial advisor may ask the member to provide. [4]
 - (vi) Set out the additional points that the financial advisor should include in any advice provided, given the information identified in part (v). [5]
- [Total 34]

3 ABC is a financial services company listed on the local stock exchange. ABC sponsors and operates a defined benefit pension scheme providing:

- a pension to members at retirement.
- an option to commute part of their pension at retirement for a lump sum.
- a lump sum and spouse's pension payable on the member's death in service or deferment.
- a spouse's pension of 50% of the member's pre-commutation pension payable on the member's death after retirement.
- options for members to take their pension benefits before or after their normal retirement date.

The scheme is administered in house by a group of ABC's pension administrators and the scheme actuary is an employee of ABC.

While considering a replacement for the retiring scheme actuary, ABC, the scheme trustees and the current scheme actuary have become concerned about conflicts of interest for the scheme actuary and the administrators being employees of ABC. The trustees have therefore appointed a specialist pension administration company to take over the scheme administration and appointed an independent consultant as the scheme actuary.

The new scheme actuary is preparing to undertake their first funding valuation of the scheme.

- (i) Outline the data checks that the new scheme actuary may wish to see completed to satisfy themselves that the data:
- (a) has been transferred to the new administrators correctly. [3]
 - (b) can be used to produce an extract of data suitable for carrying out a funding valuation. [5]

The new scheme actuary wishes to ensure that the forthcoming valuation results, based on the new data extract, are consistent with the previous funding valuation.

- (ii) Describe the process that the new scheme actuary should follow to achieve this objective. [7]

The new scheme actuary has performed the valuation and identified an inconsistency with the previous valuation's results. This inconsistency arises from the current valuation of pensioner liabilities being significantly higher than expected compared to the previous valuation.

The new scheme actuary has been unable to identify the source of the inconsistency and has therefore requested a meeting with the previous scheme actuary.

(iii) Explain how each of the following principles of the Actuaries' Code might be relevant to the meeting:

- integrity
- compliance
- speaking up.

[8]

The outcome of the discussions is the discovery of an error dating from the time when the scheme had very few pensioners. At that time the prudent assumption for active members, that no commutation takes place at retirement, was carried across to the pensioner calculations.

The previous scheme actuary's calculations, despite having access to the actual spouses' pensions payable on the death of each pensioner member, had mistakenly continued this error because its impact had increased only gradually as more members retired. The effect of this is that the pensioner liabilities have been understated for many years.

(iv) Having regard to the Actuaries' Code, outline what, if any, information should be communicated to the following parties, and by whom:

- The trustees
- The directors of ABC
- The shareholders of ABC
- The members of the scheme
- The pension regulator for the local area
- The actuaries' professional body.

[8]

[Total 31]

END OF PAPER