EXAMINATION

14 April 2008 (pm)

Subject SA4RSA — Pensions and other Benefits Specialist Applications

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 25 minutes at 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 parts of the question, beginning your answer to each part 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.

Question 1

A large South African company (Company DC) which is listed locally and internationally has employees in South Africa who are members in one of several defined benefit pension funds or in one defined contribution fund (Fund DC). In regard to its local operations the Company comprises several operating divisions and subsidiaries. Each division/subsidiary has its own defined benefit fund and an employee of a particular division/subsidiary became a member of that division/subsidiary's fund on commencement of employment as a condition of employment.

Fund DC is a pension fund that is not required to submit to valuation in terms of section 16 of the Pension Funds Act. It is a typically simple defined contribution fund without any involved or complex features. The fund provides a benefit equal to an accumulation of member and employer contributions net of expenses and reassurance costs, to which is added the investment return net of investment management fees. This benefit is payable in the event of exit from the fund by any cause. There is also a lump sum death and disability benefit.

Some of the defined benefit pension funds were established very many years ago. Membership of any particular defined benefit fund was based on the division/subsidiary in which an employee was first employed.

Company DC has a history as an acquisitive conglomerate. But it has always left intact the existing pension arrangements of the businesses it acquired, and it has furthermore never interfered in the operation of any fund. While it was once a very successful company, it has for several years experienced declining profits. A new management team has been tasked with the responsibility to restructure Company DC.

As part of the restructuring arrangements, Company DC decided two years ago to oblige all new employees, irrespective of the division/subsidiary of employment, to become members of Fund DC and this decision was implemented It also aimed to transfer all of the active members of the various funds to Fund DC.

Some funds resisted the planned changes.

Company DC usually acquires the full ordinary share capital of any company it takes over. But in the case of Company A it has only a 50% stake. There are two other shareholders of Company A, namely Companies B and C, each with a 25% stake.

Fund A is the defined benefit fund of Company A. It operates as a multi-employer fund in which companies DC, B and C participate as employers.

Fund A has assets of the order of R14 billion with a membership of 10 000 active members and 5 000 pensioners. Its last statutory valuation was made as at 31 December 2005, which showed that the employers' required rate of contribution had increased to 20% of pensionable salaries under the projected unit credit method. The trustees of Fund A have always tried to act in the best interests of the pensioners.

Companies B and C have not yet embarked on any restructuring of their benefit arrangements.

Whereas it is known that Company B has employees in other funds, Company C only has employees who are members of Fund A.

Company DC gave notice of its intention to terminate its participation in Fund A two years ago. Since then Fund A has not been able to admit new entrants from Company DC. Company DC stated that it would no longer contribute to Fund A, and that the active contributing members of Fund A, who were employees of Company DC, must transfer to Fund DC. But no transfer has occurred.

At the time notice was received, the advisers/administrators of Fund A, acting opportunistically, urged the trustees of Fund A to purchase annuities from a life office. They argued strongly that this would protect the interests of the pensioners. They also argued that there was a need to act urgently and that the annuity purchase should be arranged before the end of the month. As a consequence of this advice the trustees, who were financially unsophisticated and relied too heavily on their advisers, agreed to the immediate purchase of annuities. This decision was implemented.

The annuities made provision for increases equal to the excess return over 8% earned in any year on the asset portfolio backing the liabilities of the life office's with profits annuity portfolio.

Besides the annuities, Fund A has R3 billion invested in equities, R1 billion in fixed property, R2 billion in bonds and cash, R0.5 billion in housing loans, and R3 billion in a guaranteed fund that operates on the basis of a vested account and an unvested account. The unvested account was equal to 25% of the total guaranteed fund investment.

There have been no benefit improvements or rule changes in Fund A for many years.

Fund A sought to have the Company DC's decision overturned in court because the trustees believed that the members of Fund A have suffered, and will suffer further, substantial financial prejudice as a result of the action and plans of Company DC. It hired you, as an independent actuary, to prepare a report to investigate the matter.

(i) Explain the main issues Company DC may have taken into consideration in making its decision:

(a) to oblige new employees to join Fund DC; and [9]

(b) additionally, to transfer those of its employees who were members of defined benefit funds to Fund DC. [2]

(ii) With regard to those funds that resisted the planned changes:

(a) outline the special arrangements that Company DC might have been obliged to consider to achieve acceptance of its plans in respect of:

1. benefits in any of its funds; and
2. financial concerns in the defined benefit funds;

[4]

(b) and explain any possible obstacles that would have had to be overcome before any special arrangement could have been implemented. [3]

(iii) Discuss the content of your report, to investigate the contention of the trustees of Fund A that the members of Fund A have suffered and will suffer substantial financial prejudice as a result of the action and plans of Company DC, under suitable headings as to:

(a) legal issues relating to Company DC's termination notice; [3]

(b) how the trustees of Fund A can gain an appreciation of the likely impact on transferring members' anticipated benefits; [11]

(c) ongoing funding and asset issues for Fund A arising from Company DC's termination notice; [11]

identifying matters on which you would need instructions from the trustees of Fund A and the historical information you require.

(iv) Discuss the issues that should have been considered or investigated when the annuities were purchased for Fund A. [16]

(v) Discuss the two options a fund would in general have when buying annuities. [8]

(vi) Discuss the matter of Company DC's withdrawal from Fund A from the perspective of Companies B and C. [15]

You have very recently submitted your report to the trustees of Fund A.

It shows that the benefits in Fund A could be expected to be very much better than those that might emerge under Fund DC in most situations, with the notable exceptions of withdrawal at the younger ages and earlier durations of service, and for benefits on death in service for members who are single with no dependants.

The trustees of Fund A have studied your report. They have the following observations and queries:

"1. While different investment scenarios have been explored in the report, each scenario is based on the same underlying '*base rate*' of return after allowance for inflation has been excluded. The report states that the '*base rate*' corresponds to the yield on longer-term inflation linked bonds (the so-called long-term real rate) plus an addition of 1%. Why has this methodology been employed, and what if the '*base rate*' earned is far greater, say twice that assumed?

2. The comparison of benefits allows for the total benefits that could be expected to emerge based on the full pensionable service to the retirement age and on the investment of all money available for retirement to that time. And it separately provides a comparison based on future service only.

2.1 Why has the analysis been approached in this way?
2.2 Why are the comparative results expressed in terms of percentages and not money?
2.3 What is the rationale for the inclusion of future service?"

(vi) Comment on the choice of the ‘*base rate*’ of return and the trustees’ query in regard thereto. [9]

(vii) Set out the points you would make in response to the trustees’ second observation and corresponding queries. [9]

[Total 100]

END OF PAPER