INSTITUTE OF ACTUARIES OF INDIA

EXAMINATIONS

12th May, 2015
Subject SA4 – Pensions and Other Employee Benefits

Time allowed: Three hours (14.45* - 18.00 Hrs)
Total Marks: 100

INSTRUCTIONS TO THE CANDIDATES

1. *Please read the instructions on the front page of answer booklet and instructions to examinees sent along with hall ticket carefully and follow without exception*
2. ** You have 15 minutes at the start of the examination in which you are required 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 answer sheet until instructed to do so by the supervisor*
4. *The answers are expected to be India Specific application for the syllabus and corresponding core reading. However, substantially the core reading material is still taken from material supplied by Actuarial Education Company which is meant for UK Fellowship examination. The core reading also contains some material which is India Specific applications or work carried out from within India, mostly the APS/GNs issued by ASI/IAI, Accounting Standards by ICAI, Indian Tax and other relevant documents and funding or accounting standards issued by other bodies outside India. In view of this, it should be noted that focal point of answers is expected to be India Specific application for work generally carried out of India. However if application specific to any other country is quoted in the answer, the same you should answer the question with reference to Indian environment.*
5. *Attempt all questions in order of sequence.*
6. *Begin answer to each question on a separate sheet, however answer to sub-questions can be on the same sheet.*
7. *Mark allocations are shown in brackets.*
8. *Please check if you have received complete Question Paper and no page is missing. If so then kindly get new set of Question Paper from the Supervisor.*

AT THE END OF THE EXAMINATION

Please return your answer booklet and this question paper to the supervisor separately. You are not allowed to carry the question paper in any form with you.

Q. 1) **i)** List the parties that have an interest in the pension aspects and their role in a M&A transaction. (4)

ii) List and explain different types of M&A transactions and outline their relevant considerations for employee benefits. (6)

iii) A global pharma multinational is divesting two business units to two different purchasers globally. The Indian entity has these two business units that will be divested to two different companies. One transaction is an asset sale while the second is a share sale. The business unit that will be a share sale has some unionized employees who are part of the collective bargaining agreement. The agreement would be valid until 31st December 2016. The transfer date for the asset sale is 1st September 2015 while that for the share sale is 1st December 2015. You have been appointed as an actuary advisor to the Indian entity who is the seller. The company provides the following employee benefits

- Gratuity that is better than the mandatory Act provisions
- Privilege leave benefit that provides for accumulation and encashment of up to 180 days
- Defined benefit pension to the unionized employees that is a final salary
- pension scheme
- Post-retirement medical benefit &
- Long term service awards

The seller is keen to have these liabilities transferred as is subject to global approvals and is looking forward to your advice suitably. Write a detailed note setting out the below:

a) Pointers for negotiation with the buyer on transition treatment for the above benefits

b) Financial considerations for the different benefit liabilities

c) Aspects to be considered for incorporating in the sale and purchase agreement and

d) Outline of the practical aspects that need to be considered for actual transfer (30)

[40]

Q. 2) Company A is an Indian Infrastructure Company with a net worth of Rs.500 crores. The Company, for last 10 years, is offering a Final Salary Defined Pension Benefits to the Members of a "**Pension Club**" comprising only of Middle & Senior Executives of the Company. The Managers joining the company at the junior level have been eligible for the entry into the Club only when they enter the Middle executive Cadre.

Benefits

Pension Benefit is 10% of Final Salary. (Final Salary for the purpose of the scheme is the basic component and excludes variable pay and other allowances). The benefits are payable only on the member reaching the Normal Retirement Age (NRA). In case of death of the executive, while in employment the pension benefits are payable to the spouse of the deceased member immediately which are insured and cost neutral to the fund. No benefits are payable in case of resignation before the Normal Retirement Age.

The Company is planning to pay the pensions for the retiring members directly and will not be purchasing annuity from the insurance companies in that case.

The contribution rate for this arrangement was initially estimated as 32.00% of the Pensionable Pay. The contribution rate was based on the following assumptions:

• Salary Escalation	5% pa
• Discount rate	9 % pa
• Expected Investment Return	10.5% pa
• Cost of providing pension of Re.1/-per month	Rs. 100/-
• Assumed entry age	40
• Pensionable Pay at age 40	Rs. 50,000/- per month.
• Number of members covered at the inception	15
• The Normal Retirement Age	60

Funding Arrangement

The Company is funding the Pension arrangement based on the Recommendations of the Scheme Actuary and Assets are earmarked separately though no separate Trust is established for administering the benefits. The funding for any member commences only when they enter into the Pension Club.

The Company has not paid any Contribution during the last two years.

The Valuation results of the Scheme as at 31.03.2014 are given as under:

Assets/ Yield	**Long Term Government Bonds -25 year Term**	**Corporate bonds including bonds issued by the Company**	**Equities**	**Cash & Short term deposits with the Bank**	**Total Value of Assets as at 31.03.2014**
Value	10 Crores	9.5 Crores	30 Crores	0.5 Crores	50 Crores
Yield	9..50% pa	9.75% pa	10.00% pa	6.00%	9.81%

• Value of Assets as at 31.03.2014	Rs.50 Crores
• Value of Accrued Benefits as at 31.03.2014	Rs.59 Crores
Actuarial Assumptions Used:	
• Salary Escalation	5.50% pa
• Discount rate	8.50,%pa
• Expected Investment Return	10%pa
• Cost of providing pension of Re.1/-per month	Rs. 110/-
• Total number of executives covered	120
• Average Age at the Valuation date	50
• Average Pensionable Pay	Rs. 98000/- per month.

There are no pensioners in payment & deferred pensioners.

The recommended Contribution Rate by the Scheme Actuary is steadily increasing over the years and the rate recommended by him for the year 2013-14 is 46.00% of Pensionable Pay.

i) Discuss the possible Sources of Deficit. (9)

The Company is concerned with the growing cost of the Pension Scheme and is seeking opinion of the Finance Director (actuarially qualified) on the growing cost & finding ways to control the same.

ii) What is the "Conflict of Interest"? Illustrate the same with reference to the Role of Finance Director. (2)

The Company has taken a decision to close the Scheme to the new entrants with effect from 01.04.2015. The existing members will continue to accrue the benefits. You are the Scheme Actuary of the Scheme and you are in the process of performing the annual Actuarial Valuation of the Closed Scheme as at 31.03.2015.

iii) Discuss the issues to be taken into account by the Scheme Actuary while conducting the Actuarial Valuation of a Scheme and summarizing the results, following the decision taken to close the Scheme with effect from 01.04.2015. (10)

The Company board has decided to start a Defined Contribution Scheme to the new eligible members. The Objective of offering pension scheme is still to attract the best talent and to promote long term service but also keeping in mind to control the cost. The Contribution will be credited to the individual Pension Account of the members. The Company also proposes to purchase annuities from insurance companies to provide Pensions when the members reach NRA. You have been advised to design a DC scheme to meet the company objectives and recommend a suitable contribution rate.

iv) a) What are the disadvantages of offering a DC scheme from the point of view of the company. (4)

b) How, as the Scheme Actuary, will you arrive at your recommendations on a suitable contribution rate for the above scheme? (10)

The Company is considering giving an option to the existing members of the Defined Final Salary Based Scheme to join the new DC scheme. The option will be available for a limited period and the option once exercised will be final and cannot be revoked. The option includes transfer of their equitable interest in respect of their past benefits into the new DC scheme.

v) a) Why the Company may be offering this option to the existing members of the DB scheme? (3)

Some of the existing members who are about to retire in the next 5 years expressed interest in joining the new scheme. They have requested that a Benefit Illustration be provided on the likely pension benefits they are to get under the new DC scheme. The Company has engaged a financial consultant to prepare the Benefit Illustration. The projected pension benefits given in the illustrations are higher than the benefits available under the existing scheme. As a result some of the members of the Old scheme joined the new DC Scheme.

b) Why some existing members of the "Pension Club" may prefer to join the new DC Scheme**.** (5)

c) What are the aspects to be considered while preparing a benefit illustration for a Defined Contribution Scheme. (8)

A member exercised the option two years before the retirement. He finds that the Monthly Pension received by him on his retirement under DC Scheme is lower than the benefits would have been available under the old Defined benefit Scheme (i.e. lower than 10% of his Final Salary) & lower than the benefits projected in the Benefit Illustration.

d) Discuss the possible reasons for the actual pension different from what is projected in the Benefit Illustration (& lower than the benefits under defined benefit scheme). (9)

[60]

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