INSTITUTE OF ACTUARIES OF INDIA

EXAMINATIONS

19th November, 2013

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 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 are 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 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; (nn) and [nn] for sub-questions and for each question respectively.*
8. *Please check if you have received complete Question Paper and no page is missing. If not 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) A conglomerate in India has a scheme that enables provision of retirement pension. Many of the entities in the group currently provide retirement benefits to their top management on the basis of this scheme. The chairman of the group is keen to optimize spend and hence as a part of that strategy, the corporate HR team has reached out you as a Consulting Actuary.

They would like to achieve the following;

1. Understand the current balance sheet position as per AS15(revised) and US GAAP.

2. Understand the future cash flow and provisioning impact of this benefit liability for the group as a whole.

3. Evaluate the scheme design and make suggestions to make it targeted to ensure that deserving members get the benefit, and

4. Explore alternatives to optimize spend and provide greater freedom to members to make investment decisions rather than the company/Trustees.

Following information has been provided to you;

Outline of the scheme:
The scheme provides for the following benefits payable only on retirement to the CEO of the different individual entities:

1. Pension of 60% of last drawn salary with inflationary adjustments per annum payable to the retiring CEO and his/her spouse for life with 50% reversion to spouse.

2. A lump sum of 25 lacs at retirement.

3. Annual benefit of 25% of last drawn salary payable for life of the retiring member to support for accommodation with no increases.

The retirement age is defined as 65 years and there are no other conditions defined in the scheme like minimum service, maximum benefit etc...

There are 10 members and 2 beneficiaries currently receiving the benefit and the group is not currently evaluating any change to their existing benefits. There are 28 CEOs of the group who are covered by the scheme and will be eligible on retirement to receive the above benefit.

The group has the following suggestions for alternatives;

1. Immediate pay out of the lump sum equivalent of the benefit.

2. Pay out of the lump sum equivalent for the pension and accommodation benefit at retirement.

3. Pay out of the lump sum equivalent in two equal installments one at age 55 and another at age 60.

In the background of the above answer the following;

i) Provide a data request with reasons for each of the information required. (4)

ii) Prepare an assumptions check list and draw out the key criteria for discussion and finalization of the assumptions to be used for the valuation for accounting/liability and cash flow projection/redesign. Also provide reasons for using the same basis or different bases for the above valuations. (6)

iii) You have been provided the opening balance sheet position of the benefit as at 1st April 2012 as below;

Balance sheet liability : INR 2250 M

Value of asset : INR 900 M

Data summary:

No of actives: 30

Average age: 45

Average past service: 6 years

Average monthly benefit salary: INR 185,000

No of retirees: 8

Average age: 62

Average pension benefit: INR 65,000

Average accommodation benefit: INR 25,000

No of beneficiaries: 2

Average age: 58

Average pension benefit: INR 45,000

Based on the updated membership data and an increase of 4% on average to pension benefit and 10% on average to benefit salary and 5% net increase in asset value, draw out the complete AS15 (revised) disclosures as per the provisions of GN26 with suitable sections and commentary. (15)

iv) Outline the differences between AS15 (revised) and FAS87/158 for the benefit of the company. (5)

v) Prepare a report to the management for discussion, covering the following with suitable commentary.

1. Background and objective.

2. The cash flow and liability projections.

3. Impact of the three suggested design alternatives.

4. Accounting and cash flow impact due to discontinuance, and

5. Other design considerations. (20)

[50]

Q. 2) The Public Sector Banks in India have a Defined Benefit Pension Plan for their employees. The Pension Plan is applicable only for employees who have joined the bank service before a particular cut-off date. The Pension Plan is closed for new entrants joining after the cut-off date.

In India there are no funding regulations in respect of Pension Plans. The banks have set up trusts in accordance with requirements of 'approved superannuation scheme' so that the schemes are tax compliant. The Schemes are funded and the Trustees have invested these funds mostly in schemes of life insurance companies. The banks also expense the benefit for financial statements through actuarial report performed for the purpose under AS 15 (revised 2005).

i) In the background of the above answer the following;

a) State the main advantages of funding from the point of view of employee members of the approved superannuation scheme. (4)

b) State the different ways in which benefits could be funded and assess each one of them from the point of view of the Banks in respect of i) security of benefits, ii) tax planning and iii) cash flow management. (5)

c) If some funding methods have to be adopted by the Banks and if it were decided to examine such methods in vogue in the United States, then explain the concepts under US Code Title 26 Section 430 Minimum Funding Standards for Single Employer Defined Benefit Pension Plans.

- Minimum Required Contribution
- Target Normal Cost (5)

ii) The Reserve Bank of India (RBI) is reported to have expressed concern over inability of many banks to plan and smoothly provide for pension benefits. RBI desired that Indian Banks Association (IBA) should issue uniform guidelines to banks in this respect.

IBA has observed that the actuarial assumptions used by the banks are determined by each bank. As a result, the assumptions used across the banks vary significantly from one to the other. IBA has also observed that many banks have chosen assumptions in a way to smoothen profits. IBA has hence issued a guideline to bring out uniformity in respect of these assumptions. The guideline requires the banks to follow some principles applicable across all Banks and also each Bank to adopt a Policy document approved by Board of the respective Bank.

In the light of the above answer the following;

a) Discuss the choice of assumptions used in an actuarial valuation of a pension plan covering aspects from APS 26. (8)

b) State and Discuss the principles that could be covered in the IBA Guidelines. (10)

c) State and Discuss the points that could be covered in the policy to be approved by the Board of the Banks. (10)

iii) The RBI is stated to be contemplating to advise Trustees of the pension schemes to examine investing and managing the Trust Funds as against the current practice of engaging life insurers to manage the same. Outline the points and discuss briefly that RBI should take in to account while formulating such an Advisory. (8)

[50]

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