INSTITUTE OF ACTUARIES OF INDIA

EXAMINATIONS

20th October 2009

Subject SA4 – Pension and Other Employee Benefits

Time allowed: Three hours (9.45* - 13.00 Hours)

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, mostly the IRDA regulation. In view of this, it should be noted that focal point of answers is expected to be India Specific application. 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, beginning your answer to each question on a separate sheet.

6. Mark allocations are shown in brackets.

AT THE END OF THE EXAMINATION

Please return your answer book and this question paper to the supervisor separately.

Q. 1) In a large public sector organization (not covered under EPS'95) in India the salary payable to its employees has two main components- Basic Pay (BP) and Dearness Allowance (DA). The organization runs a recognized Provident fund (PF) scheme.

About 15 years back the organization introduced a Defined Benefit (DB) pension scheme, as an option, in lieu of the employer's contribution to PF. The scheme offers pension benefits with $1/66^{th}$ accrual rate where dearness relief on basic pension is linked to the Consumer Price Index for Industrial Workers. The final pensionable salary is the average pay drawn by the member during last ten months of his service. The scheme also provides family pension and commutation is offered up to $1/3^{rd}$ of the member's basic pension based on age based Fixed Commutation Factors.

The pension scheme was made effective retrospectively and was made compulsory for prospective employees. The then existing employees were given option and majority of them, particularly the older ones, joined the scheme.

When the scheme was introduced the management and employee unions were of the view that the cost of the scheme may be around employer's contribution to the PF. It is not clear whether or not it was based on any actuarial valuation/advice taken at that point of time, though some articles had appeared in the print media at that time indicating the open ended liability for the organization and higher cost.

The fund of the scheme started by transfer of Employer's share in PF in respect of Members (i.e. those employees who joined the scheme). Thereafter Employer's contribution to PF for Actives has been discontinued and the same is being diverted to the scheme's fund every month. The organization, in this manner, is running the scheme as partly funded. Soon it became clear to the organization that the cost of the scheme is much more than expected. Some of the employees who had not joined the scheme (i.e. non-members) wanted to join it subsequently but the same has not been permitted.

The wage revision in the organization takes place after every four years. Recently it has become due and the talks are going on between employee unions and the management where the issue of pension scheme deficit has surfaced. Both sides are aware of the large pension scheme deficit and have agreed, in principle, to sort it out. For non-members the rise in wages (normal rise) has been agreed between the two sides. For others i.e. active members the management has offered much lower rise (say, 30% of the normal rise). The Unions have disagreed on the plea that high inflation is affecting employees' current living standard and hence they will not agree unless employees' current take home pay is adequately increased. Meanwhile following two proposals have come forward during the recent round of talks:

(i) The accrual rate of pension scheme to be reduced prospectively from 1/66th to 1/100th and those who agree to it may be given a non-pensionable high salary rise (say, 150% of the normal rise). The revised scheme may even be offered to non-members for whom it may be effective retrospectively. The active members who do not opt in favour of this reduced scheme and want to continue in the original one will be given lower pay rise.

(ii) The present DB scheme to be closed down and a new separate DC pension scheme to be set up for new recruits as well as for future service of existing employees. The existing employees will also be given an option to transfer the value of their past service DB pension into the DC scheme. Further, for those who do not agree to transfer their accrued pension to DC plan, the DB scheme will be run on closed basis and their accrued pension to date in the DB scheme will be linked to the final pensionable salary at their future date of exit or retirement.

You are an actuary and the management has approached you to advise them on these proposals with particular reference to the following:

(a) The basis on which the existing scheme's deficit should be measured. (6)

(b) The advantages and disadvantages of the first proposal to the Organization and the employees. (11)

(c) The factors that the organization needs to consider in deciding the level of non-pensionable wage rise to be paid to the active members opting in favour of the first proposal of reduced pension. You should include comments on the actuarial aspects but are not required to set out a basis. (10)

(d) Outline the factors which need to be considered in the second proposal in calculating the transfer values for those active members who wish to transfer their past services benefit into the DC plan. (10)

(e) Any practical issues that may need to be addressed in the implementation of the first proposal. (3)

(f) The practical issues to be considered in operating DB plan (closed scheme) for active members who do not opt to transfer their past service benefit to DC plan in the second proposal. (10)

[Total 50]

Q.2) A multinational having Head Quarters in the UK has a number of business units and has operated in India for some ten years. It has one single Defined Benefits Approved Superannuation Scheme covering all the Business Units in India. The company has decided to sell one of its business units to another Multinational (also UK based), having operations in India which also has an Approved Defined Benefit Superannuation scheme. Both the multinationals have Defined Benefits schemes in the UK and thus have to comply with the requirements of the Accounting Standards Board of the UK, besides complying with the relevant Laws and Accounting Standards as are applicable in India.

You are an Actuary and practise in Benefits Consulting amongst clients such as above. CFOs of both the Multinationals have had a number of issues, particularly about AS 15 (rev. 2005), thinking that it is a replica of IAS 19 and also about utility of financial reporting under AS 15 (rev.2005) for Sale/Purchase transactions. In this context you are required to respond to the following questions;

(a) Describe differentiating aspects with explanations therefore of AS 15 (rev.2005) with that of IAS 19 (amended Dec. 2004). (15)

(b) Describe and discuss, giving the background, the best practice guidelines issued by the Accounting Standards Board of the UK. (15)

(c) Outline the issues which the Seller has to take in to account. (5)

(d) Discuss the relevance of immediately preceding actuarial valuation carried out under AS 15 (rev.2005) of the Sellers' approved Superannuation scheme. (5)

(e) Describe various methods which could be adopted to quantify the amount of fund to be transferred from Seller's fund to the Buyer's fund. (10)

[Total 50]

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