Institute of Actuaries of India

Subject SA4: Pension & Other Employee Benefits

March 2017 Examination

INDICATIVE SOLUTION

Introduction

The indicative solution has been written by the paper setters with the aim of helping markers of scripts so as to have a framework and be consistent while evaluating answers. The solutions given are only indicative. It is realized that there could be other points as valid answers and the marker may give credit for any such alternative approach or interpretation which the marker considers to be appropriate.

Solution 1:

i)

a) Currently the accounting disclosures would assume a going concern basis - if we were to switch it to a more realistic basis given the winding down then:

For Gratuity

Future working lifetime (FWL) of actives will considerably reduce (from current reasonably expected 10 years)

Approx weighted future working lifetime now could be about 1.5 years given number of employees reduction numbers given for the gratuity plan

With a lower FWL this would likely mean a lower discount rate (given past upward sloping yield curve). An approximate rate may be 6.5% p.a. currently

Gratuity impact will depend on the number of employees currently impacted by the Gratuity cap of INR 10 lakh.

The accrued benefit at 31 December 2016 could be approximated as 200 x (1.07/1.04)^10 = 265 million under the assumption most employees are not capped

Assuming no employees currently capped the DBO would change to approx. 200 x (1.07/1.04)^10 x (1.04/1.065)^1.5 = c.250 million INR

During the year about half the accrued benefit will be paid out reducing the DBO to c.130 million (250 less half of 265) and allowing for some interest cost but no service cost.

Assuming all employees currently capped the accrued benefit would be 500*1,000,000 = c.500 million INR

Assuming all employees currently capped the DBO would change to approx. 200 x (1.07)^10 /(1.065)^1.5 = c.358 million INR

During the year about half the accrued benefit will be paid out (assuming average profile of outgoing members) reducing the DBO to c.120 million (358 less half of 500) and allowing for some interest cost but no service cost.

There is a large impact due to the reduction in discounting period - the exact impact will depend on how many employees are currently impacted by the cap.

The impact of this will go through the income statement as a curtailment loss and be recognised immediately in 2017 in the P&L

This can be separately worked out for the employees remaining post 2017 and those who leave during 2017 (as they will have had their benefit payments as well)

For Funded Pension

For Actives = DBO as at 31 December 2016 could be estimated as 600 x (1.07/1.04)^10 x (1.04/1.065)^1.5 x 13/11.4 (for change in commencement timing of annuities) = 860 million

Retirees would not be affected and we can ignore the impact of any small discount rate change if the 6.5% is applied to them too.

Given half the members will begin receiving pension the DBO very approximately could be about 500 million at end of 2017.(half of 860 million plus some interest and service cost)

As the Plan is closed to new entrants in 2010 - all members are vested and will be due a benefit

For Increasing Pension

For actives difference in PBO at 31 December 2017 can be approximated as 1000 x ((60-13)/1.065^1.5)/((37-11.4)/1.07^10) = 3,288 million

(difference in annuity at 45 for increasing vs non-increasing annuity divided by difference of that at age 60 - with the adjustment for future working lifetime change as well).

However, a point for serious consideration would be to change the pension increase assumption from 10% pa. to 5%p.a.

For actives this could reduce the 31 December2016 estimated PBO: 3,288 x (25-13)/(60-13) = 839 million

For retirees this could reduce to 2500 x(19-11.4)/(37-11.4) = c.740 million

The total is about 1,570 million and even after 1 year it would be similar as the actives on leaving will just become retirees.

The above change in the pension increases assumption would go through the Other Comprehensive Income

Given the circumstances there may be a case to reduce the pension increases to zero as they are discretionary.

The change in DBO for the pension increases portion would be difficult to measure (in view of the limited information available) for retirees as the current DBO will include the amount being paid for past increases applied and future increases. Only the future increases could be reduced down to zero.

It means the total DBO of 2,500 million for retirees would NOT disappear.

However, for the actives 1,000 million would reduce to zero.

(15)

b) <u>Beyond 2017</u> Once the adjustment is made in the first year the accounting will revert to a more stable scenario

FWL will continue to fall each year and that needs to be considered for setting the discount rate

Each year there will continue to be a current service cost for remaining members, and interest cost

As numbers reduce one could remove the attrition assumption and use actual anticipated dates of leaving of each member

Timing of leavers benefit payments can be factored in more accurately for interest cost calculations

There may be a settlement gain/loss impact to take through the P&L in the year when the final company / plans are wound up.

This will arise as the retirees' commutation restoration pension needs to be secured somehow

Also there will need to be a decision on how future pension increases are met after wind up which may cause a settlement gain/loss.

(3)

ii)

Change in discount rate assumption due to change in FWL and market yields movement

Difference in estimated numbers of employees leaving each year i.e. change in wind up plans and its timing and pace

Mortality experience, especially amongst retirees

Salary increases for remaining members being different than the 4% p.a. assumption

If the assumption for pension increases is not changed then the actual increases compared to assumptions

For the gratuity plan there would be leavers who are not vested - the mix of the service of employees when they leave changing may cause a gain/loss (As company is forcing to leave, gratuity might need to be paid even if not vested)

If the annuity terms at the time of securing the pension are different

The demographics of the remaining employees don’t stay homogeneous

(4)

iii)

Only applies to Gratuity and Funded pension plan

Based on the latest accounting valuation, after the adjustments for the wind down scenario, the company could decide to contribute to the extent of any deficit

When each accounting period valuation is done this can be determined again

Given there may be a little surplus the company could decide not to contribute at all and let the fund wind down - this would be a better strategy given the circumstances

6 monthly valuations could be done to assess the funding position and the company can plan ahead for the timing of when the fund will go down to zero. Further more realistic valuation assumptions may be adopted, say discount rate, withdrawal rate etc.

Following that - the company could determine the funding at that stage or then implement a just in time funding (i.e. pay the Trust as people leave and are due their benefits).

The important point will be to try not to leave a surplus in the fund, if possible on the wind up.

As the company is going to wind down within 5 years change of valuation method for determination of contribution to say, Aggregate method may be a better option

(3)

iv)

Gratuity & Funded Pension Merge the Trust with another similar Group Company Trusts via a Deed of Participation

<u>Feasibility of this option will depend on:</u>

Availability of a similar Trust in the Group, particularly for pension

If it can be proved enough that there is a linkage to the group companies overseas - even though they are different entities and no common holding company in India. This will be easier if there are common Directors and similar tax assessment jurisdictions of each of the participating companies.

Funding position of the winding up entity on an ongoing basis is slightly in surplus. One needs to consider what the impact of merging has on the funding position.

This is even more important as the winding up company will require cash flows to pay benefits as employees leave during the impending wind up of that company.

The management and Trustees of the other Group companies' willingness to take on the administration / responsibility of the winding up companies' benefits.

This will make a difference especially in administering the pension fund restoration of the commuted pension

Pros

Maintains continuity for members with the Group (even if one subsidiary is winding up)

Funds stay in the Group and any additional costs are not incurred immediately in securing the benefits

A technical Wind up of the Trusts does not need to happen as the Trusts would just merge - this removes a lot of administration activities when the company winds up.

There would be less need to liquid assets to meet winding company's benefit payments. This does depend on the size of the combined scheme and contributions coming in from other Group companies of the Trust.

Cons

Would be cumbersome if the benefit formulae and set up are not consistent across the Group companies

If merger possible - the entities are still separate and so the overall merged Trust would still need to track investments/admin separately. This is not easy in a pooled defined benefit scenario.

Receiving Trustees / Company has to manage the legacy tail for the funded pension commuted pension restoration. This may last many years into the future.

Keep Pension and Gratuity Trust as is and pay out benefits as they become due

No need to look at feasibility as this maintains status quo in terms of Trusts. Pay out the benefits due as employees leave.

Pros

Gratuity and Funded Pension (base pension) are essentially lump sum payments and so obligation will cease once someone leaves. This means it is administratively and financially clean as possible.

For Gratuity and base pension - keep paying out benefits from the Trust and when that runs out the Trust to be wound up and any remaining benefits due could just be paid from the company.

Does not involve another Group company and so upfront transition activities not required.

Cons

Requires even closer eye on cash flows and financial obligations of each Trust to ensure that the winding company can tightly plan for meeting benefit payments as they become due.

Assets will need to start being liquidated and there maybe losses on those which can't be mitigated due to having to meet benefit payments.

Internal Knowledge transfer about the Trust and its activities will need to be managed very closely as employees leave - which may include current Trustees and HR teams.

Alternative solution for legacy commuted pension restoration of retirees will need to be found outside the Trust as the legacy will go beyond 2021. There will be no company around then. The Trust will not be able to be wound up until a solution is found for that legacy.

Solution to any surplus remaining will also need to be found and so timing of company wind up and Trust wind up needs to be coordinated suitably.

<u>Commuted Pension restoration and unfunded pension increases Secure benefits with an insurance company</u>

Will depend on whether matching benefits are available in the market

Company will need to assess what the cost of those products are

If a ready product does not exist then will an insurance company create a product?

<u>Pros</u>

Removes legacy and so Trusts can be wound up timely with the company

Employees / Retirees in knowledge that benefits have been secured, albeit subject to the risk of the insurance company fulfilling its obligations

<u>Cons</u>

Likely to be costly due to insurer risk appetite and pricing assumptions

Members may feel at risk that their benefits now secured by external party and no recourse to Trust/Company

There will be large immediate cash flow outlay from the company/Trust

<u>If matching benefits not available in the market then secure actuarially equivalent benefits that are available in market</u>

<u>Pros</u>

Removes legacy and so Trusts can be wound up timely with the company

Employees / Retirees in knowledge that benefits have been secured, albeit subject to the risk of the insurance company fulfilling its obligations

No additional costs to the company directly as benefits secured on actuarial equivalence

<u>Cons</u>

Likely to be costly due to insurer risk appetite and pricing assumptions and so now the members benefits may be seen as lower to them.

Members may feel at risk that their benefits now secured by external party and no recourse to Trust/Company

Extensive communications with members will need to take place to explain what benefits have been secured and to convince them of the equivalence and the calculation basis etc...

There will be large cash flow outlay from the company/Trust

<u>If matching benefits not available in the market then pay actuarially equivalent cash to members</u>

<u>Pros</u>

Removes legacy and so Trusts can be wound up timely with the company

Employees / Retirees in knowledge that benefits have been secured

No additional costs to the company directly as benefits secured on actuarial equivalence

members have flexibility on how to use their funds

<u>Cons</u>

Extensive communications with members will need to take place to explain what benefits have been secured and to convince them of the equivalence and the calculation basis etc...

There will be large cash flow outlay from the company/Trust

Employee / retirees will likely have additional tax burden if secured as cash - this may be an additional cost that the company may need to gross up for.

Does not guarantee the funds will be used for pension purposes

(15)

v)

Ensure easy continuity of appointment and resignation of Trustees

Requirement of minimum Trustees and quorum for decision making - make it per the minimum as per IT Act requirements

Review wind up trigger clause to ensure there is flexibility in how and when the wind up can be triggered.

Ensure flexibility in contributions to be made in the Gratuity and Pension fund Trusts

Review usage of funds on wind up clause to have flexibility in usage of surplus and also how funds can be used (i.e. increase benefits to members / return to company subject to tax)

(2)

vi)

<u>Deficit</u>

Additional contributions from the Company at the time of securing benefits

Secure additional funding from the Parent company if the winding up company does not have funds

Apply windup priorities according to the Trust Deed & Rules for each plan

- This will be more applicable to the pension fund.

- for example Base pension of those leaving the company secured first; followed by past retirees restoration followed by those leaving service restoration

- If required – pro-rata reduction in benefits may need to be applied

<u>Surplus</u>

If allowed in the TD&R then increase members' benefits

As part of the Deed of Wind up - apply for a return of the surplus to the company, subject to tax

(3)

vii)

Company giving notice to the Trustees of its intention to cease contributions and wind up the plan

Review administration records to ensure:

- Full details of all members available

- e.g. retirees: date of retirement; current pre commuted and post commuted pension at retirement); full contact details and last existence check; spouse's details for survivor pension/nominee; full details of pension increase being paid from the company

- e.g. current actives: full contact details; correct service dates; date of birth; spouse's / nominee information; correct pensionable salary

Review assets and compile plan for maturities; liquidations and cash flow requirements for managing funds during the wind up

Outreach to any members not contactable via various means including newspaper Notification to contact trustees with proof of identity and entitlement of benefits

At the very end ensure only asset are cash in the trustee bank account and then finally close the Trustee bank Account

Draft a Deed of Dissolution setting out how the benefits are being secured and funds being applied

Draft a Deed of Discharge that sets out the ceasing of the Trustees' responsibilities on the wind up of the Trust

Make a final set of audited financial statements showing the fund accounts to be down to Zero

File Deed of Discharge and Dissolution along with final accompanying documentation to the Income Tax office for approval

(5)

[50 Marks]

Solution 2:

i) The Company is providing Gratuity as per Gratuity Act 1972. The act mandates for the benefits as per the prescribed formula subject to a maximum amount of Rs. 1 million.

Therefore, there is a risk that the minimum level of benefits may be revised by the Government and the Company has no control over it. The revision may be in accrual or in revision of the ceiling of Rs. One million

The revision will increase the cost to the company. The risk is further increased if the benefits are revised retrospectively.

Presently those employees who leave before completion of 5 years service (vesting period) do not get gratuity benefit on resignation. If the government relaxes vesting condition, the cost may go up

Removal/reduction of vesting period may increase employee attrition.

The Government encourages employers to fund the Gratuity liability by offering tax relief on the contributions under section 36 i(v) of Income Tax Act 1961. The relief is restricted to 8.33% of annual contribution.

There is a risk that there may be reduction in the tax relief given under the above provisions. This may increase the tax burden and may force the company to alter the funding strategy of the scheme.

The funds related to gratuity trust are to be invested as per the pattern prescribed by the government. There is a risk that the prescribed pattern may be made more restrictive.

The past service and the current service costs are usually measured for accounting purposes with reference to the yield available on g-sec bonds of term matching with outstanding service duration of employees (eg 10/15 years). There is a risk that the yield available on the bonds is declining over the period.

This will increase the cost recognised the Profit & loss account and also increase the past service vested benefits leading to higher contribution requirements.

In case the company is investing Gratuity funds with insurance companies, there is a risk that the investment return offered by the insurance companies may decline.

This may arise due to reasons such as poor investment performance of the insurance company or general economic outlook or regulatory restrictions or introduction of new tax (eg service tax). This will increase the contribution requirements of the company.

Gratuity & other retirement benefits are measured, recognised & disclosed as per the guidelines provided by the Accounting profession. For instance, the actuarial gains & losses are recognised immediately in the P&L account as per AS 15® 2005.

There is a risk that there are revisions in the guidelines in terms of measurement, recognition & disclosure. This will significantly alter the measurement of cost, contributions and will impact the profits of the Company. If there is revision in Accounting Standards (eg introduction of IND AS19) in recognising the Actuarial Gains & losses (eg through Other Comprehensive Income), the revision will impact the financials of the company significantly.

There will be additional onetime cost to the company in implementing the revised guidelines.

(7)

ii) a) In case of sale/purchase of a business organisation, the sale/purchase may be partly or fully.

Where the business is partly sold, employees may or may not be transferred. However, where a business is fully sold, employees are generally transferred to the buyer.

Where no employee is transferred there is no question of employee benefits.

Where transfer of employees from seller to buyer takes place, gratuity and other employee benefits provided by the seller need to be dealt with.

Statutory benefits such as gratuity and Provident Fund (PF) need to be provided by the buyer post purchase of the business.

Gratuity is a defined benefit (DB) arrangement and if transferring employees agree, it may be paid to them for their accrued service by the seller. In such case employees will join the buyer company with new appointment date.

However, if the seller or the transferring employees don't agree for immediate settlement, then the employees are transferred with their original date of appointment and past service entitlement to the buyer company.

Provident Fund is a defined contribution (DC) funded arrangement in which every employee has his share of assets and hence past benefit entitlement may not be affected by the transfer. Post sale of the business the transferring employees accrue such benefit prospectively under the new company.

Other voluntary benefits such as life insurance cover, medical benefits, leave encashment; pension (either DB or DC) may or may not be provided by the buyer depending on whether or not such benefits are provided by buyer to its existing employees or due to other reasons such as retention of such transferring employees.

In case of contingent benefits such as life insurance or medical benefit, such benefits are generally arranged through insurance providers on a yearly renewable basis. If the entire company is being purchased, then the policies providing such benefits are transferred to Buyer Company on the purchase date and the cover may continue till next renewal date. The value of unexpired duration of policy may or may not be considered for adjustment in the purchase price of the business depending on its materiality.

If pension benefit is available to transferring employees on DC basis, then its treatment will be on lines similar to the PF benefit mentioned above.

Where accrued gratuity or other DB retirement benefits such as leave encashment, or pension are involved, they need to be valued and their value need to be agreed to by both the buyer and seller. The agreed value is then adjusted in the purchase price of the business being purchased.

If the seller has funded arrangement for gratuity and/or other DB retirement benefit, then agreed value may be paid out of the fund of the seller's scheme and the balance, if any may be adjusted in the purchase price.

(7)

b)

Documents required from the buyer	**Purpose**
Trust deed & Rules	To understand the benefits being offered, funding & investment policies of the Trust, Power of Trustees
Valuation report of the Scheme Actuary	To understand the value of benefits accrued, the basis used by the scheme actuary in his calculations, the profile of transferring members such as age, salary, past service distribution of transferring members, funding level, purpose of valuation report, Past experience of scheme, any material changes during inter valuation period and their impact on scheme's funding.
Schedule of assets;	To understand the quality of assets (eg credit rating of bonds, listed/unlisted companies whose equity/bonds held, Dividend paying/not dividend paying companies whose equity is held, distribution of assets into different asset classes, whether investment regulations are complied with, geographical/industry wide distribution of companies whose equity/bonds are held, level of self investment, if any)
Annexure to financial statements	Helps to understand the realistic cost of retirement benefits as reflected in P&L account, the unfunded liabilities as reflected in Balance sheet, the impact of change in basis in pension cost as reflected in Actuarial gains & losses
Employee data	Helps to reconcile the data used in valuation, movement of data over inter valuation period
Communication to members, discussion with	Helps to understand the impending improvements in benefits which may impact the cost, the promises made to transferring

the representatives	employees, if any; whether benefits communicated to employees tally with the benefits stated in the Rules of scheme and benefits valued by the actuary, if any .
Employee Handbook	To see the description of the benefits given by the seller to its employees so that any inconsistencies / and therefore risks can be looked into.
Sample employment contracts and any special executive contracts	To consider what has been committed to employees about benefits and especially looking for discretion of the employer to be able to change benefits for future service. Special contracts may stipulate special benefits for particular senior members.

(6)

iii) a)

- During the initial stage of the negotiation full information about value of gratuity & other retirement benefits is not available. The negotiations are often conducted over a short duration generally in secrecy with the result it becomes impossible to carry out the necessary investigations into employee retirement benefit aspects which might be desirable in an ideal situation. The initial bid is therefore quoted based on the limited information provided by the seller company. During the due diligence process, access to more detailed information about the scheme is needed to know more about the level of benefits offered, the method & bases of valuation etc

- The main objective is to measure the realistic value of the accrued liabilities of employee benefits offered by the seller. The buyer may want to ensure that the value of benefits is not understated so that the purchase price of business considers the true underlying values.

- Such due diligence provides an opportunity to firm up valuation price of the company

- It may help to Identify potential issues that may have any material impact on future cost to the Company, eg impending wage negotiation, unresolved labour disputes etc
- Assess the materiality of the benefit cost to the purchase price of the company

(3)

b)

Due diligence exercise in respect of employee retirement benefits is likely to cover the following aspects.

- Should reflect the objectives of the client – The Company B may want to ensure that the value of accrued benefits of transferring members is rightly reflected in the purchase price. Specifically it may want to ensure that the value of vested benefits is not understated.

- Data validation – should assess the quality of data used in the valuation exercise. Should examine whether the full members' data is used or the valuation is based on selected model points and then aggregated. If full members' data is used, the consistency check is performed by the actuary to ensure the quality. How does the data compare with initial information provided? Does it differ significantly in terms of quality?
- Check whether a common actuary is used by Company A and their trustees or a different actuary is used. Further it needs to be verified that approach used for arriving at the liability figure does not differ materially from that of Scheme Actuary.
- Benefits valued: check the benefits valued in the valuation exercise. Whether the benefits payable on retirement, death & resignations are consistent with Scheme rules.
- <u>For Example:</u>
    - How the ceiling of Rs. 1 million is treated – whether as soon as the projected accrued benefit crosses the limit or in some other way
    - Whether the valuation takes into account the accruing (but not vested) benefits of new members (who have not completed the minimum service)
- Level of prudence built into the calculations and how does it compare with the initial information provided. It needs to be ensured that sufficient margin for prudence is included in the calculations
- In this context due diligence exercise should compare the strength of the assumptions used in funding, accounting & sale process calculations & the method used to value the benefits and ensure that they are fairly consistent.
    - For instance the gap between i - e have been fairly consistent across valuations? Do the decrements such as resignations, mortality are materially different?
    - For instance, the funding & accounting valuations might have used PU method whereas the sale process valuation might have used CU method, then there is a possibility of understating the transferring liabilities
- In the initial information provided, there is a deficit of 15% - due diligence should assess the actual deficit level by comparing the funding deficit as reflected in the Scheme Actuary's valuation report & in the company's financial statements. Ideally the Company B will want to take account of the deficit in the purchase price calculations.
- Quality of assets backing the vested benefits. It includes the type of assets such as equity bonds or corporate bonds with their credit ratings etc. If funded insurance products are used by the scheme, may wish to give allowance for expense loadings, surrender penalty

- Should go through Trust Deed & Rules of Scheme A to ensure that Scheme A Trustees do not have undue powers and the transfer of necessary funds will take place smoothly
- It should also be verified that the benefits available to employees in both the companies do not differ materially and the financial burden and/or administrative difficulties to be faced in future by Company B needs to be assessed

(8)

iv) a)

Presently the value of PSB per member of scheme A and B for different group of members is as under:

Average Age	Scheme A	Scheme B
25	33,333	60,000
40	366,667	477,500
55	600,000	2,360,000

Assumptions

- The age, past service and salary distribution of members of both the schemes A & B is similar
- There are no decrements in both the schemes due to resignation, death or other causes from this date till merger of schemes
- The valuation method and assumptions used for the scheme post merger are the same which were used for valuation of scheme B
- The members of scheme A will be getting gratuity without ceiling with retrospective effect
- There is no change in the value of assets of both the schemes till merger
- Method of valuation of assets is the same for both the schemes

  Thus based on above assumptions, the value of PSB per member for scheme A members post merger will be similar to that of scheme B.

Therefore the funding level of combined scheme post merger may be arrived at as under:

Average age	Monthly Salary	number of members	Past service	Value of PSB per member	Value of PSB for the age group (in million
25	30000	1950	5	60,000	117
40	100000	2600	10	477,500	1241.5
55	150000	650	30	2,360,000	1,534
				Total value PSB	2892.5
				Total assets	2,612
				Funding level	90.3%

Following the merger the funding level of the combined scheme B falls from 105% to 90.3%. **(7)**

b) Assuming that the assumptions in iv) a) above are true, following the merger of scheme A into scheme B, the funding level falls from 105% to 90.3%.

There are three reasons for it:

i. The benefits of employees of company A have increased. Earlier there was a ceiling of Rs. One million on gratuity benefit which has now been removed with retrospective effect.

ii. The basis of valuation for company B is stronger. There is a gap of 2% in discount (i) and salary escalation (e) rates for scheme B whereas the gap for scheme A is 5%.

iii. The funding level of scheme A is 85% which is much below the funding level of scheme B

Reconciliation:

- In order to have 105% funding level, the assets in the merged scheme should have been Rs. 3037 million (=1.05*2892.5). Hence the total shortfall in scheme B is Rs. 425 million (=3037-2612) after merger
- The shortfall due to enhancement of benefits will mainly be for 55 average age group members. Some shortfall may be for 40 average age members which may be ignored. No shortfall is expected for average age 25. Hence the shortfall due to enhancement of benefit is of the order of Rs.217 m [={(15/26*30*0.15*150)*(1.03/1.08)^5-90}]
- The shortfall due to assumptions will be for employees of all age groups. The shortfall for age groups 25 & 40 due to change in assumptions will be Rs. 78.5 m [={450*(60,000-33,333) + 600*(477,500-366,667)}]
- The shortfall due to change in assumptions for age group 55 will be Rs. 47 m [=(15/26*30*0.15*150)*{(1.04/1.06)^5-(1.03/1.08)^5}]

- There is already a shortfall of Rs. 49m {=(325-276)} in scheme A
- Thus shortfall for 100% funding level due to
    - Increase in benefits is 217m
    - Change in basis is 125.5m (=78.5+47), and
    - Initial shortfall of 49m
- Hence total shortfall for 100% funding level is Rs. 391.5m (= 217+125.5+49) and for105% funding level the shortfall is Rs. 424.88m (= 1.05(276+391.5)-276) which tallies with shortfall of Rs. 425m assessed for merged scheme initially

(7)

c) The Trustees of Scheme B have professional responsibility to protect the interests of members of Scheme B. They should ensure that the benefits of members of Scheme B especially, vested benefits are not diluted by the merger.

They should also ensure that the interests of transferring members of Scheme A are protected. Further they should have been allotted benefits consistent with the assets transferred into the scheme.

They should ensure that the transferring members (in the age group 55) do not get priority over the Scheme B members in settlement of benefits as they approach superannuation.

As the funding level of their scheme falls significantly:

- They can insist Company B to pay additional contribution to make good the shortfall either in one go or over a period of time
- The transferring members may be allotted proportionate benefits in respect of their past service in proportion of the assets transferred. The trustees may come out with a formula in consultation with their actuary to pay proportionate benefits from the scheme at the time of exit of the concerned employee and the balance may be made good by Company B

Should consider "ring fencing" of assets relating scheme B members. But keeping two groups of members with different benefit levels will cause administrative difficulties. This may also cause potential legal disputes in future.

Should initiate a dialogue and agree with company B on how to manage the deficit following the merger & insist that the deficit is financed by Company B before the members of Scheme A are admitted into the Scheme B.

If the covenant of the company B is good following merger, may agree to the financing of the deficit in PSB of Members A over a future period (say 5 years).

Should discuss with Company B & decide on the funding of benefits for future service of transferring members following merger

Should make necessary amendments in the Trust deed & Scheme rules **(5)**

[50 Marks]

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