Pensions Management Institute
ACHIEVING PENSIONS EXCELLENCE

PMI
Floor 20, Tower 42
25 Old Broad Street
London EC2N 1HQ
T: 020 7247 1452
F: 020 7375 0603
W: www.pensions-pmi.org.uk

# International 2:
# Managing International Employee Benefits

## Assignment 2 Notes

*(Part 3 – Funding and Risk Management of Long Term Employee Benefits*
*Part 4 – Management and Provision of Risk Benefits)*

1. **Explain how the funding position of pension funds has changed since the 1990s, the external factors impacting on this and why this has led to the closure of many Defined Benefit plans.**

**10 marks**

Your answer should include:

- The funding position of Defined Benefit plans has deteriorated in general due to a fall in asset values;
- reduction in interest rates (leading to a fall in discount rates used to value liabilities and therefore an increase in the value of these liabilities) and
- improved life expectancy.
- Coupled with increase in legislation which often require benefit improvements, accounting rules and administration requirements, this has led to the closure of many Defined Benefit plans.

(The relevant section of the study manual is the Introduction to Part 3 Chapter 1)

2. **How do regulators affect a company's funding decision and practice?**

**15 marks**

The key challenge answering this question is to keep to the time limit and decide which points are important to cover.

Your answer should include the following points:

- General Introduction to role of regulators for 2 or 3 marks
- List and brief description of areas where regulations impact on funding practice:
  - Regulation concerning frequency and the way in which actuarial valuations are undertaken including method, assumptions (including the setting of an appropriate discount rate), disclosure requirements and qualifications required for those carrying out the valuation
  - Regulation concerning insolvency
  - Treatment of surplus and deficits
  - Maximum and Minimum Funding standards
- Two or three examples of how these impact in practice (e.g. if regulation requires that all surplus belongs to members , this will reduce the tendency of companies to overfund)

(The relevant section of the study manual is Part 3 Chapter 1.3.)

PMI
Floor 20, Tower 42
25 Old Broad Street
London EC2N 1HQ
T: 020 7247 1452
F: 020 7375 0603
W: www.pensions-pmi.org.uk

3. **Give two examples of how a company's business objectives may affect its employee benefit funding decisions.**

**5 marks**

This question requires you to take two examples from the study manual and describe the link between business objectives and funding policy

(The relevant section of the study manual is Part 3 Chapter 1.3.3)

4. **How may a company change the nature of benefit provision so as to reduce the risk it takes on? Give three examples.**

**15 marks**

This question asks for 3 examples of risk reduction and risk transfer.
Examples of risk reduction include moving to Defined Contribution or Hybrid pension provision, reducing the level of guarantees, changing the definition of certain elements (e.g. average salary used for calculation of benefits etc.).

(The relevant section of the study manual is Part 3 Chapter 1.4.6)

5. **Describe the difference between passive and active investment management, including potential advantages and disadvantages of each approach.**

**10 marks**

This question requires a clear description of the key differences.

(The relevant section of the study manual is Part 3 Chapter 1.4.3)

6. **List the elements that make up the pension cost determination for international accounting purposes and briefly describe three of these elements.**

**5 marks**

This question requires the listing and brief explanation of the seven elements of pension cost. By 'briefly describe' the question is looking for one or two lines of explanation.

(The relevant section of the study manual is Part 3 Chapter 1.5.3)

7. **Define and compare Loss Carried Forward and Stop Loss insurance systems**.

**10 marks**

For this question it may be useful to include a numerical example if that helps the explanation and demonstrates to the examiner your knowledge.

(The relevant section of the study manual is Part 4 Chapter 1.1.1)

Pensions Management Institute
ACHIEVING PENSIONS EXCELLENCE

PMI
Floor 20, Tower 42
25 Old Broad Street
London EC2N 1HQ
T: 020 7247 1452
F: 020 7375 0603
W: www.pensions-pmi.org.uk

8. **Describe the quantitative and qualitative factors to take into account when choosing a Multinational pooling network.**

**15 marks**

The question requires distinction between financial and non-financial drivers.

Financial drivers (quantitative factors) are based on the principle that by increasing the number of lives insured, the insurer has a lower risk (of fluctuation) and that this is reflected in lower premiums thereby reducing risk management costs.

Pooling also:
- Identifies/unlocks excessive insurance margins
- Realises economies of scale
- Exploits experience rating
- Brings cash flow enhancements

Non Financial Drivers (qualitative factors) include:
- Improved risk management (e.g. increased investment return on reserves, possibility to use captive insurance company etc)
- Increased guaranteed coverage levels
- Improved quality of reporting and increased transparency (e.g. worldwide experience reporting on an annual basis)
- Improved underwriting conditions

(The relevant section of the study manual is Part 4 Chapter 1.1.4)

9. **Define a Captive Insurance company and outline the main reasons why a Captive is set up by a multinational.**

**15 marks**

The definition of a Captive and why they are used are set in the study manual). The answer should include both objectives and strategic advantages which are explained in this sub-section.

(The relevant section of the study manual is Part 4 Chapter 1.2)