Core Unit 4 - Financing and Investing for Retirement Provision

Multiple choice questions

Generally the multiple choice questions were answered very well and the average score was high.

In relation to the short answer questions, candidates should remember to state what may seem obvious facts to them as marks are often available for this. The examiners would also remind candidates to study the whole manual; it is very clear when otherwise good candidates have not studied one or more particular sections. The short answer question are designed to cover the entire syllabus and are not restricted in any way.

Question 1

Describe what longevity risk is and how longevity swaps might provide some protection against it. (10 marks)

The relevant section of the study manual was Part 2, Chapter 2.1.
On the whole this question was reasonably well answered. Candidates are reminded that a longevity swap is not a buy in and no marks were available for a detailed description of a buy in process.
Most candidates were able to explain that longevity risk is the risk of members living for longer than expected so that pensions are payable for longer and that life expectancy has increased over recent decades. Marks were also available for explaining that this is an unrewarded risk so that it is logical to minimise it and that the risk applies to DC members too either in relation to increased costs of buying an annuity or of a member's pot running out before death. Candidates gained marks in relation to longevity swaps for explaining that these can relate to pensioners or deferred members and provide protection for a specified time period. Marks were available for describing a swap mechanism and distinguishing between a swap where payments are based on actual longevity and one where payments are based longevity compared to pre agreed assumptions, which offers only partial protection as it is not specifically linked to scheme membership.

Question 2

Explain what is meant by a lifestyle investment strategy.(10 marks)

The relevant section of the study manual was Part 5, Chapter 1.3.1.
This question was very straightforward and could have been answered easily by candidates who had studied the relevant part of the manual. The examiners were disappointed that some candidates appeared not to have done so and many candidates missed out on easy marks by not stating the obvious. Candidates should have explained that a lifestyle investment strategy is an investment strategy that automatically switches funds to lower risk asset classes as a member approaches retirement. Many candidates mentioned that this is a common default investment strategy. Additionally, marks were available for explaining that there are two phases, the growth phase typically continues until 5-10 years before a selected retirement date when the consolidation phase begins and for describing typical investments in each period. Good candidates gained marks for explaining why equity investment is less suitable as a member approaches retirement and for explaining that taking cash or drawdown at retirement rather than buying an annuity means a traditional lifestyle strategy may no longer be appropriate so that many schemes offer more than one option. Candidates could also have gained marks for explaining that the advantage of a lifestyle strategy is that members are not required to manage their own derisking process.

Question 3

Explain what self investment is in relation to a pension scheme.(10 marks)

The relevant section of the study manual was Part 3, Chapter 1.5.
On the whole, this question was answered fairly well, although candidates should take care with facts. There were many incorrect statutory references and many candidates referred to dates or limits which were incorrect. Marks were available for explaining that trustees must not invest more than 5% of

scheme assets in employer related investments or invest in employer related loans. Many candidates were able to list examples of employer related investment, including shares in the employer or employer group, land occupied or used by the employer or other property used for the employer’s business. . Good candidates also referred to units in collective investment vehicles and payments from insurance policies invested in the employer. Marks were also available for stating the limits are relaxed in relation to small member schemes and do not apply to one member arrangements and for giving a rationale for the limits applying.

Question 4

Describe the four common methods of equity valuation techniques used for equity analysis. (10 marks)

The relevant section of the study manual was Part 4, Chapter 1.4.
The examiners were disappointed that this question was answered rather poorly as it is very straightforward. Many candidates appeared not to have studied the relevant part of the manual. Marks were available for listing the four methods from the manual, namely return on invested capital, price to earnings ratio, dividend yield and price to book ration. Further marks were available for correctly describing each method and for explaining the implications of each, for example that a higher dividend yield leads to the conclusion of an attractive value assuming the dividend is sustainable or a higher price to earnings ratio could mean the shares are overvalued or that the company has superior growth prospects.

Question 5

Describe what is meant by delegated management and fiduciary management. (10 marks)

The relevant section of the study manual was Part 4, Chapter 1.4.
This question was answered very poorly. Many candidates appeared not to understand what the terms meant or be confused as to what each involves. Marks were available for explaining that delegated management allows trustees to outsource part of the decision making process, while retaining the setting of the risk/return budget. Candidates should have explained that delegated management allows the investment consultant to provide clearer, real time recommendations compared to the traditional model, resulting in assets being managed in a more dynamic, efficient manner. Candidates could also have gained marks for stating that fiduciary management is an extended version of delegated management which involves a fiduciary manager who is accountable for implementing an overall strategy adopted by the trustees with all day to day decision making delegated within pre agreed guidelines, allowing trustees to focus on other areas. Candidates who mentioned the recent CMA report on fiduciary management gained marks for that.