

# EXAMINATIONS

10 September 2001 (am)

## Subject 401 — UK Fellowship Investment

### *Paper One*

**You must answer this subject only,  
you may not attempt another subject in the 400 series.**

*Time allowed: Three hours*

### **INSTRUCTIONS TO THE CANDIDATE**

1. *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.*
2. *You must not start writing your answers in the booklet until instructed to do so by the supervisor.*
3. *Write your surname in full, the initials of your other names and your Candidate's Number on the front of the answer booklet.*
4. *Mark allocations are shown in brackets.*
5. *Attempt all 7 questions, beginning your answer to each question on a separate sheet.*

### **AT THE END OF THE EXAMINATION**

*Hand in BOTH your answer booklet and this question paper.*

*In addition to this paper you should have available  
Actuarial Tables and an electronic calculator.*

- 1 The trustees of a UK pension scheme have been advised by their investment consultant to consider investing in a “manager-of-managers” fund for each of the asset classes in which the scheme is to invest. Describe the possible advantages and disadvantages of this approach. [14]
  
- 2 Describe briefly the Institute of Actuaries’ Conduct of Business Rules. [15]
  
- 3 You are the investment consultant to a large pension fund. The principle of investing in property has been agreed at earlier trustee meetings and you have been asked by your client to advise on a proposal the trustees have received from a property developer. The developer has proposed the fund takes on a combination of a part share in the property and debt security in their project, alongside other institutional investors.
  - (i) Contrast the two types of financing from the fund’s point of view. [6]
  - (ii) Discuss briefly how, if at all, the existing investment portfolio might need to be changed as a result of accepting this investment. [4]

[Total 10]
  
- 4 You are a director of an investment boutique offering a range of domestic funds. Market research has suggested there will be a demand, were your company to offer international funds, particularly a global equity fund.
  - (i) Outline the primary advantages and disadvantages of increasing the range of funds in this way. [5]
  - (ii)
    - (a) Discuss the options for structuring a global equity fund, stating a preference for the benchmark to be adopted. [3]
    - (b) Suggest alternative funds which could be offered to meet demand for international equity exposure. [2]

[Total 10]
  
- 5 You are a director of a UK listed company specialising in “business to business” internet software. The company has been operating for three years and is on target to meet its business plan. Along with your two fellow directors, you have this year drawn a salary from the business and in addition, have received share options which have varied considerably in value over the last six months. Apart from your share options, your principal assets are a deferred pension from your previous employer’s defined benefit scheme, your house, which is shared with your partner (also a director of the company) and your two school-age children and an insurance policy maturing in ten years, which you plan to use to pay off your mortgage.
 

Following the death of a family member, you have been left £200,000.

- (i) Discuss the factors that need to be considered in determining your personal investment strategy. [5]
  - (ii) State the asset types available for investment, commenting where they best fulfil your investment objectives. [5]
  - (iii) Discuss briefly the range of tax-efficient investment vehicles which could be used to implement your investment strategy. [5]
- [Total 15]

**6** As the investment director of a trustee company controlling a large UK pension fund, you have, for some time, been concerned about the performance of your North American equity portfolio. You currently employ two investment managers with equal shares of total assets of £800 million. Both are active managers and their performance is assessed at quarterly meetings based on each manager's own performance statistics. You have been asked by your chairman to commission an independent performance monitoring company to help assess this part of the portfolio.

- (i) A quarterly report is required for consideration by the whole trustee board, some of whom are not knowledgeable on investment issues.
  - (a) Discuss the performance-based information you would wish the performance monitoring company to include in its report. [6]
  - (b) Describe the additional risk focused data you would wish to see. [2]
- (ii) Following a detailed discussion of the independent report, it has been suggested that the committed "value-based" style of investment of one of the managers has been largely responsible for the overall poor performance. [3]
  - (a) Define the value investment style and comment on whether you believe it to be appropriate for the pension fund.
  - (b) Suggest how the investment manager's skill could be assessed, given their style of investment management. [3]
- (iii) Having concluded the discussions on the North American equity performance, it has been agreed that alternative arrangements be considered for this part of the investment strategy.

Describe the process you would go through to fully re-assess the management of North American equities. [6]

[Total 20]

- 7** ABC plc is listed on the London Stock Exchange and has traded options. Its current share price is 106 pence and the table below shows put and call option premiums (in pence) for three exercise prices and three expiry dates.

<i>Exercise Price (P)</i>	<i>Call Option Expiry Dates</i>			<i>Put Option Expiry Dates</i>		
	<i>May</i>	<i>August</i>	<i>November</i>	<i>May</i>	<i>August</i>	<i>November</i>
100	19	26	32	11	17	21
110	15	22	27	16	22	26
120	10	17	22	20	26	31

- (i) Define the following terms:
- (a) a bear spread [2]
  - (b) a calendar spread [2]
  - (c) a butterfly [2]
- (ii) Show, using the above table, how intrinsic value varies. [2]
- (iii) Explain briefly why this happens. [2]
- (iv) Using the data above illustrate the profit profile for:
- (a) a strap [3]
  - (b) a butterfly [3]

Ignore dealing and any other expenses. [Total 16]