

INSTITUTE AND FACULTY OF ACTUARIES

EXAMINERS' REPORT

September 2017

Subject ST5 – Finance and Investment Specialist Technical A

Introduction

The Examiners' Report is written by the Principal Examiner with the aim of helping candidates, both those who are sitting the examination for the first time and using past papers as a revision aid and also those who have previously failed the subject.

The Examiners are charged by Council with examining the published syllabus. The Examiners have access to the Core Reading, which is designed to interpret the syllabus, and will generally base questions around it but are not required to examine the content of Core Reading specifically or exclusively.

For numerical questions the Examiners' preferred approach to the solution is reproduced in this report; other valid approaches are given appropriate credit. For essay-style questions, particularly the open-ended questions in the later subjects, the report may contain more points than the Examiners will expect from a solution that scores full marks.

The report is written based on the legislative and regulatory context pertaining to the date that the examination was set. Candidates should take into account the possibility that circumstances may have changed if using these reports for revision.

Luke Hatter
Chair of the Board of Examiners
December 2017

A. General comments on the *aims of this subject and how it is marked*

1. The aim of this Finance and Investment Technical A subject is to instil in successful candidates the ability to apply, in simple situations, the principles of actuarial planning and control to the appraisal of investments, and to the selection and management of investments appropriate to the needs of investors.
2. A mix of questions styles is used, covering *knowledge* of the material set out in Core Reading, *application* of this in calculations and case studies and *higher order skills* such as synthesis and collation of recommendations. Marks are awarded for the constituent elements of calculations, not just for the final answer generated. Scenario appraisal will similarly provide credit for evidence of the issues considered, not solely for the conclusions reached.
3. Candidates who give well-reasoned points, not in the marking schedule, are awarded marks for doing so.

B. General comments on *student performance in this diet of the examination*

Overall the performance was satisfactory, however it was observed that in some cases students were unable to apply their knowledge and adapt their answers to the scenarios described in the questions.

C. Pass Mark

The Pass Mark for this exam was 59%.

Solutions

- Q1** (i) The study of behavioural finance theory is useful as decisions in investment markets are often made by people. [½]
- While these people believe they are rational they are often influenced by past experiences [½]
- and by what other people are doing. [½]
- The way in which a question is presented can also influence the answer [½]
- so understanding these factors can help investors to avoid some of these situations. [½]
- Or they could benefit from others' biases/errors. [½]
- [Max 2]
- (ii) (a) The behaviour demonstrated is anchoring [½]
- The actuary is using the inflation rate in the previous valuation as a reference point and has maintained this view despite the currency collapse. [1]
- Or exhibiting a status quo bias [½]
- The actuary prefers to keep things unchanged and therefore does not change the inflation rate. [1]
- (b) The investor is exhibiting confirmation bias, [½]
- as they are concentrating on articles that confirm their beliefs. [1]
- (c) Here the two questions demonstrate framing. [½]
- In the questions the use of the words long and short can influence the responder's answer. [1]
- (d) This demonstrates the primary effect. [½]
- This is the theory that individuals will remember or prefer things better if they are first on a list than if they are later in the list. [1]
- Hence the first fund mentioned is most popular despite it not being the best substitute. [½]
- [Max 6]
- [Total 8]

Generally speaking this question was answered well with most candidates identifying the relevant behaviours.

- Q2** (i) There are no contributions being paid into the pension scheme and so there is a total reliance on investment returns. [1]
- Due to the need to liquidate assets regularly to pay benefits, the fund will experience two key issues - forced asset sales perhaps at inopportune times [½]
- and larger allocations to cash to provide liquidity [½]
- both may mean a reduction to asset returns. [½]
- Lower asset returns feed through to weaker funding levels and higher funding costs (but the sponsor is not currently paying any cash in). [½]
- There is a heightened sensitivity to market falls [½]
- real risk of falling into a funding spiral as there is no possibility of making good the asset loss after a shock to the asset base. [½]
- There is also a lack of diversification in the investment strategy so that the fund is heavily exposed to the equity markets. [½]
- There is a mismatch risk as liabilities will not all be matched by equities. [1]
- A relative performance risk – both to peers and liabilities. [½]
- Risk that they unable to meet liabilities as they fall due. [½]
- There is also the possibility of regulatory intervention. [½]
- And there is sponsor covenant risk. [½]
- More general risks are longevity. [½]
- Cost inflation. [½]
- And salary inflation. [½]
- And there is an investment risk. [½]
- [Max 4]
- (ii) Request contributions from sponsor as that will have a significant impact on overall strategy. [½]

The investment strategy could diversify away from just equities into other assets that better match the liabilities. This could reduce risk without necessarily impacting on the expected returns. [1]

One solution could be to invest in a buy-in policy [½]

or other high income assets to match the current cash flows out of the scheme. [½]

Include some leverage [½]

Or LDI assets to hedge out inflation and interest rate risks [½]

– the leverage allows significant exposure to hedging with limited assets. [½]

Invest remaining assets in a growth portfolio to get required returns to pay full benefits over the longer term. [1]

Longer investment horizon on growth assets permits focus on collecting illiquidity and other risk premia etc. [½]

Investment decisions may be made solely on investment considerations, i.e. without the constraint of cash-flow generation. [½]

Consider other alternatives like taking liabilities off balance sheet through insurance solutions [½]

or undertaking liability management exercises to remove inflation risk etc. [½]

Increase risk to raise return – assuming a good sponsor covenant. [½]

Improve efficiency by reducing costs – e.g. adopt a more passive approach. [½]

[Alternative strategies that focus on the cashflow negative aspects given credit.]

[Max 6]

[Total 10]

Many candidates struggled on this question. In part (i) most recognised that the fund was overexposed to equities, however few mentioned that the fund would have to liquidate assets to pay benefits. In part (ii) only a small minority of candidates suggested asking the sponsor to contribute.

Q3 (i) There are two definitions of ROCE:

- (a) Profit before interest and tax/ (share capital+ reserves + long term debt);
- (b) Profit before tax/ (share capital + reserves)

Either [½]

(a) Capital employed = 63,200K [½]

ROCE = 37.0% [½]

(b) Capital employed = 58,800 [½]

ROCE = 42.2% [½]

PER = ordinary share price / earnings per share [½]

EPS = 17,900,000 / 77,000,000 = 0.2325 [½]

PER = 4.4 / 0.2325 = 18.9 [½]

Dividend Cover – The number of times that the dividend payments are covered by earnings for the relevant period. Defined as: earnings per share / dividend per share [½]

Dividend per share = 6,500,000 / 77,000,000 = 0.0844 [½]

Dividend cover = 0.2325 / 0.0844 = 2.75 [½]

Gross Dividend Yield – The annual income on an investment divided by its current market value [½]

= 0.0844 / 4.4 = 1.92% [½]

Working Capital – Current assets minus current liabilities [½]

= 71,500 – 26,400 = 45,100 [½]

[Max 5]

(ii) **ROCE**

ROCE is an indicator of a company's efficiency in generating profit from its asset base. [½]

A higher ROCE indicates a more efficient use of capital; [½]

so the ROCE should be higher than a company's capital costs otherwise the company is not generating shareholder value. [½]

ROCE is useful to compare profitability. [½]

Adjustments may be needed for companies that are holding a lot of cash, since cash is not actively employed in the business but is counted as part of capital employed [½]

Equally, intangible assets may need to be excluded as difficult to value. [½]

The trend in ROCE is much more informative than a single figure. [½]
[Max 1.5]

PER

Company X is trading at a PER of 19 which means that investors are willing to pay £19 for £1 of current earnings. [½]

In general, a high P/E suggests that investors are expecting higher earnings growth in the future compared to companies with a lower PER.
A high P/E may indicate the company is overvalued. [½]

A lower PER may indicate that a company is undervalued or that a company is doing much better than in prior periods. [½]

It is very difficult to compare the PER across sectors as they will experience very different growth rates and valuations. [½]

PER comparisons are often made with companies operating in the same industry. [½]

To determine whether a PER is high or low you also need to assess how fast has the company been growing in the past, and are these rates expected to increase, or at least continue, in the future. [½]

The earnings per share used can be historic or prospective which will impact the underlying measure, e.g. is it historic which may not be appropriate for the future or it may be a projection which could be subjective. [½]

There is also the possibility that earnings are manipulated by the company. [½]

A loss making company will not have a PER. [½]

Earnings can be defined by differing accounting rules in different countries. [½]
[Max 1.5]

Dividend cover

Dividend cover measures a company's ability to pay out dividends, so that a higher number indicates a greater ability to maintain dividends if profits were to fall. [½]

It is important to look at how stable a company's earnings are, e.g. it might be OK to pay low dividends where profits are stable, but a similar level of dividend cover in a company with volatile profits would indicate that the payment of dividends could be at risk. [1/2]

Trends are therefore important again here. [1/2]

It is the inverse of the payout ratio. [1/2]

Care needs to be taken that the tax treatment of the earnings and dividend figures are consistent. [1/2]
[Max 1.5]

Gross dividend yield (GRY)

The gross dividend yield for company X is 1.92%. This is low compared to the average for equity. [1/2]

The dividend is a cash payment made to shareholders and is cash the company does not need for investment. [1/2]

Companies that are growing fast often have a low GRY as they are reinvesting a lot of the cash they are generating. [1/2]

Whereas low growth companies often have fewer opportunities to invest cash and therefore return higher amounts to their shareholders. [1/2]

Again it is useful to look at the level of dividend payments in the past, a smooth progression being the preferred path. [1/2]
[Max 2]

Working capital

A measure of a company's short-term operating resources: useful as a measure of both a company's efficiency and its short-term financial health. [1/2]

If the ratio is less than one then they have negative working capital. [1/2]

A high working capital ratio is not always a good thing, as it could indicate that a company has too much stock or they are not investing their excess cash. [1/2]

Long term investors need to also consider other aspects. [1/2]
[Max 2]
[Max Total 6]

- (iii) All accounting ratios just provide a snapshot of information and so should form part of a broader analysis. [1/2]

Each company needs to be considered individually, but some important general factors are:

management ability – [1]

does the management have a proven track record in delivering results for shareholders? Meetings with management to understand their plans for the company would help in deciding whether to invest. [1/2]

quality of products – [1]

does the Company have a respected brand or reputation for producing high quality products? [1/2]

prospects for market growth – [1]

is the Company a new start up (although the pension obligations suggest not) with high expectations of growth, or is the Company part of a declining industry? [1/2]

competition – [1/2]

does the Company operate in a monopoly or oligopoly? Are there barriers of entry to other possible competitors? [1/2]

input costs – [1/2]

are input costs in the control of the Company or do external forces impact on profitability, e.g. the price of oil. Does the Company hedge any of these risks? [1/2]

retained profits – [1/2]

what are the current and historic levels? Do current levels of retained earnings reflect a specific objective, e.g. to pay off debt or purchase a capital asset? [1/2]

history – [1/2]

consider the historic performance of the Company, although noting that the past is not necessarily a guide to the future. [1/2]

The risk metrics for the company – operational & financial. [1/2]

The capital structure. [1/2]

The industry in which the company operates. [1/2]

The liquidity of the company. [1/2]

The regulatory environment. [½]

The economic conditions [½]

[Other valid comments accepted.]

[Max 6]
[Total 17]

Most candidates scored highly in part (iii), however the marks in parts (i) & (ii) were much more diverse. Well prepared candidates scored highly while those who were less well prepared struggled. Most could calculate gross dividend yield and dividend cover and could define, but not calculate, price earnings ratio.

Q4 (i) (a) The competition authorities' concern will be aimed at the protection of the interests of customers and suppliers. [½]

They will be concerned that the merged company could have a dominant market share in either the entire snack market [½]

or just within the narrower crisp market. [½]

In either case this may result in the merged company abusing its market position which may result in the making of excessive profits either from squeezing its suppliers [½]

or by lowering the quality or quantity or raising prices to the consumers. [½]

The competition authorities would also need to consider the other competitors within the domestic snack market [½]
and if the merged company would increase the barriers to any new entrant into the market. [½]

(b) The directors of the company run the company on behalf of the shareholders. However they also have a duty towards all their stakeholders i.e. anyone who may be affected by the company's operations. [½]

This means they need to consider the impact of the bid on all these groups before deciding to recommend the bid or not.

Therefore the directors should principally consider:

Is the price being offered fair, taking account of the current position of the Crispy Crisp Company (CCC) [½]

and its future prospects. [½]

- What will the impact of the merger be on CCC's employees? [½]
- They may also consider the impact on themselves. [½]
- Is Delicious Snacks (DS) likely to close the operations and move the plant to another location? [½]
- What will the bid mean to the pensioners of CCC? [½]
- This will depend on what arrangements have been made to provide pensions to the CCC employees in the past and the level of solvency within any pension fund. [½]
- They may also look at the potential upside and synergies. [½]
- While customers and suppliers are also stakeholders, their interests will be covered by the competition authorities. [½]
- (c) The shareholders of CCC will want to ensure that the value of the bid fully reflects the company's value. [½]
- They would also need to look at the exact terms of the bid, e.g. is it all cash, a mixture of cash and equity, or all equity. [½]
- If equity is involved what are the prospects for DS; is the equity fairly valued? [½]
- What would the impact be on the shareholders' income [½]
- and would acceptance of the bid give rise to a tax liability? [½]
- What would be the impact the potential impact on their investment portfolio? [½]
- (d) The government of CCC's home market will be concerned with how the takeover will impact the economy of the country. [½]
- Apart from the competition issues there may also be employment [½]
- and tax issues. [½]
- Is CCC a large employer either nationally or in particular regions; [½]
- if so what might the impact of the takeover be in these areas? [½]
- Does CCC pay a significant amount of tax; [½]

if so could the takeover result in CCC being restructured in such a way as to reduce or eliminate the tax paid? [½]

They would also be interested in any significant investment that CCC plan to make. [½]
[Max 12]

- (ii) The competition authorities could tell DS that they will have to sell some of their operations in CCC's home market so as to reduce their market position. [½]

They could also conduct a market study to assess the impact of the bid. [½]

They may also have the option of blocking the bid depending what their powers allow. [½]

The directors can ask DS to increase the level of the bid if they think it undervalues CCC. [½]

They can also seek assurances regarding the security of the pension fund [½]

and determine what plans DS have for the operations of CCC. [½]

They may try to find another bidder who is preferable (a white knight) [½]

The shareholders can ask DS to increase their bid [½]

or they may vote against the bid [½]

or to restructure it to make it more attractive e.g. more cash less equity. [½]

The government could block the takeover on grounds [½]

of national interest. Alternatively it could seek assurances regarding any restructuring or job losses. [½]

[Max 3]
[Total 15]

This was the question that produced the poorest answers. The majority of candidates did not seem to know what is meant by a takeover, they often based their answers on a merger which led them down low scoring paths. In part (i) most candidates gained marks when talking about the competition authority and government, however they seemed to have a very tenuous grasp of the role of directors and shareholders. Few seemed to think directors would have many concerns except for their own job security and most did not seem to realise that shareholders were the owners of the company.

- Q5** (i) A first step would be to determine the use of the index, e.g. to measure the performance of the global bond market or as a benchmark to reflect an investor's objectives. [1]

You would need to determine the specific universe of bonds to be included and the methodology for including and excluding the bonds. [½]

The price index would be constructed as a weighted arithmetic index, the weights being the market capitalisation of the bonds. [1]

Either of the following two formulae could be used:

$$I(t) = K \frac{\sum_i w_i \frac{P_{i,t}}{P_{i,0}}}{\sum_i w_i}$$

$$I(t) = \frac{\sum_i N_{i,t} P_{i,t}}{B(t)}$$

– terms need to be defined. [1]

The indices could be chain linked to allow for new issues, redemptions and movements of stocks between categories. [½]

The total return would also need to be calculated to allow for the income received from the bonds. [½]

The index could be subdivided by credit rating, currency, term to maturity, industry etc. [½]
[Max 4]

- (ii) Constructing a bond index is more complex than an equity index as the bond universe is so much more diversified, with many different types of bonds [1]

(e.g. convertible, callable etc.), varying term to maturity [½]

and various credit ratings. [½]

You would therefore need to consider:

- the number of bonds included in the index (e.g. fixed or floating) [1]
- the weighting given to each bond [½]
- the term to maturity, e.g. exclude bonds with less than a year to maturity [½]

- credit rating, e.g. only include investment grade bonds [½]
- any minimum issue size, to improve liquidity [½]
- when/how to rebalance the index [1]
- how to deal with currency movements [½]
- how to deal with defaulted bonds [½]
- Frequency of calculation [½]
- How to base the index- relates to accuracy & depends on use [½]

Some of the bonds in the index may have no observable market price if trading in an illiquid market, which would mean that a price would need to be estimated from transaction pricing or using a pricing model. [½]

Treatment of the income would need to be determined, e.g. are coupons reinvested and if so, how/when? [½]

If the index is to be used as a benchmark for an investor, the evolving nature of the investment universe means there would be a need for constant monitoring of whether the investor will meet their objectives. [½]

One specific flaw with bond indices is that they have typically been produced by banks using their internal models so that the same index measured by a different bank could produce a different valuation. [½]

Also, there has been a tendency to include a greater exposure to debt from financial institutions than the market as a whole. [½]
[Max 6]

(iii) A measure of short-term market movements. [½]

Providing a history of market movements and levels. [½]

As a tool for estimating future movements in the market, based on past trends. [½]

As a benchmark against which to assess the investment performance of portfolios. [½]

Valuing a notional portfolio. [½]

Analysing sub-sectors of the market. [½]

As a basis for index funds which track the particular market. [½]

To provide the basis for the creation of derivative instruments relating to the market or a sub-section of the market. [½]

A standard against which yields on other fixed interest investments can be assessed. [½]

Approximate valuation of a fixed interest portfolio. [½]

Providing a picture of general yield structures of fixed interest investments. [½]

Yield indices allow comparison to be made with yields on ordinary shares as a measure of the yield gap between bonds and equities. [½]

Help price new issues [½]

Used to discount liabilities [½]

Can be used to estimate level of risk comparing corporate bonds with government bonds. [½]

[Max 4]

[Total 14]

The answers to this question were satisfactory with part (ii) producing maximum marks for candidates who had studied the core reading.

Q6 (i) The term risk budgeting refers to the process of establishing how much investment risk should be taken [½]

and where it is most efficient to take risk in order to maximise return. [½]

(ii) A “feasible” set of asset classes that could be included in the portfolio [1]

(subject to any constraints specified in the mandate / investment agreement) [½]

are first analysed.

This will consider the expected returns, [½]
volatilities [½]

and the covariances [½]
between asset class returns.

Some risk / return optimisation process is then used to select an initial asset allocation between the asset classes. [½]

A Value at Risk (VaR) assessment will be used to determine the total risk budget [1]

– the risk tolerance in respect of the exposure to potential loss on the portfolio. [½]

The total risk budget is then allocated between strategic risk [1]

and (total) active risk, [½]

There may also be some structural risk [½]

and finally the total active risk is allocated among the various asset managers. [½]

An ALM may be used in this process. [½]

It is important that the developing position of the chosen portfolio is monitored to assess risk exposures (increases and decreases in the value of the positions) [1]

and changes in volatilities and correlations. [½]

The portfolio will need to be rebalanced in the light of such changes, in order to keep the overall portfolio risk at the level defined as tolerable. [½]

[Max 6]

(iii) Daily volatilities are: asset X – £3,500 ($£0.7\text{m} \times 0.5\%$) [½]

Asset Y – £2,000 ($£0.4\text{m} \times 0.5\%$) [½]

Sigma of portfolio = $(3500^2 + 2000^2 + 2 \times 0.6 \times 3500 \times 2000)^{1/2}$ [½]

= £4964.9 [½]

The 1-day 95% VaR is then

$(1)^{1/2} \times 1.6449 \times 4964.9 = £8,167$ [1]

[3]

(iv) The daily volatility of asset X is:

$(1)^{1/2} \times 1.6449 \times £3,500 = £5,757$ [½]

The 1-day volatility of asset Y is:

$$(1)^{1/2} \times 1.6449 \times £2,000 = £3,290 \quad [1/2]$$

Thus the benefit of diversification is $(£5,757 + £3,290) - £8,167 = £880$ [1]

[2]

(v)

- VaR assumes normal distribution of returns; [1/2]
- if the distribution of returns is “fat-tailed” or skewed, tracking error focus on standard deviation of returns may be misleading. [1/2]
- Portfolios exposed to credit risk, systematic bias or derivatives may exhibit non-normal distributions. [1/2]
- The usefulness of VaR in these situations depends on modelling skewed or fat-tailed distributions of returns, either in the form of statistical distributions or via Monte Carlo simulations. [1/2]
- However, the further into the “tails” of the distributions, the more lacking the data material and hence the more arbitrary the choice of the underlying probability becomes. [1/2]
- Doesn't take account of simultaneous increase in asset volatilities and correlations as is often the case in extreme market conditions. [1/2]
- The choice of parameters is subjective. [1/2]
- The use of complex models can introduce model/operational risks. [1/2]
- The past doesn't imply what will happen in the future. [1/2]
- It looks at potential losses so it is looking at the downside only. [1/2]

[Max 2]

[Total 14]

Most candidates gained their marks in the descriptive parts of the question with few being able to provide the correct answers to the numerical parts. The vast majority of candidates did not explain what they were calculating which meant that the examiners found it difficult to award marks when the answers were incorrect.

Q7 (i)

	<i>Start</i>	<i>End Year 1</i>	<i>End Year 2</i>	<i>End year 3</i>
Fund A	100	106	101	112

Fund B	100	108	99	113
Index	5000	5304	5145	5620
Gross				
	<i>End Year</i>	<i>End Year</i>	<i>End year</i>	
<i>Absolute</i>	<i>1</i>	<i>2</i>	<i>3</i>	<i>Total</i>
Fund A	1.060	0.953	1.109	1.120
Fund B	1.080	0.917	1.141	1.130
Index	1.061	0.970	1.092	1.124
	<i>End Year</i>	<i>End Year</i>	<i>End year</i>	
<i>Relative</i>	<i>1</i>	<i>2</i>	<i>3</i>	<i>Total</i>
Fund A	-0.08%	-1.72%	1.66%	-0.40%
Fund B	1.92%	-5.34%	4.91%	0.60%

[2]

(ii) **Inc Management Fees** – performance fees taken off gross figures

Inc Management Fees

	End Year	End Year	End year	
Fund A	1	2	3	Total
Gross at year end	106.000	100.495	110.883	
Management fee	0.530	0.502	0.554	
Perf Fee				
Net at year end	105.470	99.993	110.328	
Relative perf	-0.61%	-2.20%	1.10%	-2.07%
	[1]	[1]	[1]	[1]
	End Year	End Year	End year	
Fund B	1	2	3	Total
Gross at year end	108.000	98.351	111.920	
Management fee	0.324	0.297	0.339	
Perf Fee	0.384		0.972	
Net at year end	107.292	98.054	110.609	
Relative perf	1.21%	-5.61%	3.57%	-1.79%
	[1]	[1]	[1]	[1]

Assume that for Fund B both the management fee and the performance fee are taken from the gross figure.

[½]

[Max 8]

- (iii) Once fees are taken off both funds underperformed over the period. [1]
- Fund A underperformed Fund B. [½]
- The performance may suggest that Fund B takes greater risk. [½]
- Gross of fees fund B outperformed. [½]
- Fund A underperformed in both years 1 & 2 [½]
- recovering most but not all of the underperformance in year 3. [½]
- On the face of it, fund B has performed well with the outperformance in years 1 and 3 [½]
- outweighing the underperformance in year 2. [½]
- While the management fee is lower for fund manager B, the performance fee significantly reduces the return in years 1 and 3. [½]
- [Max 4]
- Other valid points were given credit*

[Total 14]

As in question 6, many candidates did not explain what they were calculating which meant when mistakes were made it was difficult to award marks. Having said that most candidates did reasonably well on the question. If candidates assumed the performance fee was calculated after the management fee had been deducted they received full marks assuming they had calculated the figures correctly.

- Q8** (i) There are a number of reasons why the fund managers' performance may differ. Many might relate to their mandates. [1]
- Typically, mandates will include the performance target, [1]
- the amount of risk they can take, [1]
- any constraints on investment [1]
- e.g. ethical, the ability to use derivatives, the assets which may be included [½]
- e.g. overseas equities, AIM stocks etc.
- Aside from the mandate, other reasons include:
- One fund manager may charge more for their services than the other. [½]

Fund manager A may be more skilful or have a better team supporting them. [½]

Fund manager A may have been luckier than fund manager B. [½]

The size of the two funds may have been very different with the smaller fund being able to be nimble and take advantage of opportunities that the larger fund couldn't. [½]

Cash flow may have impacted performance [½]

Or differing investment styles [½]

Or one may use stock lending and the other doesn't. [½]

They may use different measures of performance [½]

Or the two time periods for performance measurement may be different. [½]
[Max 5]

- (ii) The arguments given regarding the mandate in part (i) will still apply when the two fund managers are the same. [1]

Other than the influence of the mandate, other reasons include:

The timing of the switch from one fund manager to the other may have meant that pension fund B missed out on a period of outperformance by the fund manager. [½]

As the fund transferred from one fund manager to the other, it may have been out of the market for a short while and thus missed some positive performance. [½]

The cost of transitioning the portfolio from one fund manager to the other will have impacted on performance. [½]

e.g. The transition may have impacted market prices. [½]

Pension manager A may have negotiated lower fees than pension manager B. [½]
[Max 3]
[Total 8]

This question was well answered; the number of marks available meant that most candidates were able to accumulate marks in both parts of the question.

END OF EXAMINERS' REPORT