

Subject CA3 — Communications

EXAMINERS' REPORT

September 2008

Introduction

The attached subject report has been written by the Principal Examiner with the aim of helping candidates. The questions and comments are based around Core Reading as the interpretation of the syllabus to which the examiners are working. They have however given credit for any alternative approach or interpretation which they consider to be reasonable.

R D Muckart
Chairman of the Board of Examiners

December 2008

Comments on question 1

Question 1

Candidates were asked to draft a letter to a pensioner member who had queried how his pension would be affected after hearing that his former employer had become insolvent. Candidates were required to redraft a complicated and over-technical initial draft response prepared by a student colleague, to cover the questions that had been raised and to explain how the member's pension would be affected going forward. The main points that the examiners were looking for and some common problems encountered were as follows.

1. Most candidates had a suitable opening paragraph to the letter. Scripts gained marks for a brief summary of the member's queries, but not where the opening paragraph was lengthy and repetitive. Most scripts were in a suitable format and tone to be a letter to a member.
2. Most candidates confirmed back to the member that the employer had become insolvent, and that this would affect the pension.
3. A number of candidates struggled to find the right words when confirming the impact of the insolvency to the member. Scripts which were overly apologetic or which skirted around confirming the pension would go down generally lost marks. Typical wording included describing the pension as "negatively impacted" or indicating that the pension would be "different" or "slightly different". Other scripts variously described the member as an "unfortunate victim of economic circumstances" or "lucky" that he would receive compensation. Likewise, scripts which were too blunt lost marks for lack of empathy.
4. Most candidates correctly stated that the pension would be reduced. Better scripts linked this directly with a description of what it would be reduced to and how the reduction was made. Many candidates left too much of a gap between stating that a reduction would occur and explaining what the reduction would be, leaving the member confused and concerned.
5. Many candidates failed to set out clearly the level of compensation the member would receive going forward. There were two distinct reductions applied: the first arising due to the compensation cap and the second due to the member having retired early.
6. Some scripts gave mathematical formulae which were totally inappropriate (e.g. "you will receive 95% of the lesser of .."). Other scripts gave the impression that the pension would be reduced from £31,000 pa to £27,368.42 p.a. before stating only much later on that the actual pension would be £26,000 p.a. – this led to a fragmented answer leaving the impression on initial reading that the member would receive £27,368.42 pa. A number of scripts were unclear in that they stated to the member the further reduction to £26,000 p.a. would be applied if he retired early – the question was clear that the member had already retired early.
7. Some scripts calculated the figures incorrectly and therefore gave incorrect information to the member. Some credit was still given for the overall reply if it was communicated appropriately.
8. There was evidence of a number of candidates going out of their way to define inflation in an over-complicated fashion. Reference to the price of a "basket of goods", standard of living, and the cost of a loaf of bread were usually inappropriate and led to

a laboured answer. The examiners were of the view that inflation is a common concept which did not require explanation in this context.

9. *Better scripts not only confirmed the new payment provisions but went on to contrast these with the current provisions. For example, whilst many scripts correctly stated that pension increases would in future be in line with inflation capped at 2%, the better scripts contrasted this to the guaranteed increases of 3% currently being received.*
10. *The better scripts made it clear that the spouse's pension was 50% of the reduced level of member's pension. Candidates used a variety of assumptions about whether to use 52 or 52.25 weeks in a year, both of which were acceptable.*
11. *Many scripts gained marks for a good final paragraph which briefly summarised the main points and finished with comments suitable for a letter to a member.*
12. *A number of scripts suffered from poor spelling, grammar and punctuation.*
13. *The guideline length was 500 words. Scripts which were below 450 words generally missed out some of the explanation. Scripts which were longer than 550 often lost marks for including unnecessary repetition or irrelevant detail.*

A possible solution is attached. In practice a wide number of solutions were acceptable.

Solution to question 1

Company Name
Company Address

Mr Landers
Address

Dear Mr Landers

Re: XYZ Pension Scheme

Thank you for your letter regarding your pension that you are receiving from the XYZ Pension Scheme.

Firstly, I would like to put your mind at rest and confirm that you are correct that the XYZ Pension Scheme is covered by the Government Pension Security Fund (the GPSF). However, the amount of pension that you will receive will reduce.

In this letter I will explain how the level of compensation that you will receive from the GPSF is calculated. I will also show the level of spouse's pension that is covered and explain the level of increases that are granted to the compensation once it starts to be paid.

Amount of compensation paid.

The GPSF makes compensation payments to eligible pensioners of pension schemes that are in financial difficulties. These compensation payments replace the pension that you are currently receiving from the XYZ Pension Scheme.

The level of compensation payment depends on your current age and the normal retirement age of your pension scheme. You are currently age 60 and you retired from the XYZ Pension Scheme before the scheme's normal retirement age of 65. The level of compensation you will therefore receive is calculated as 95% of the pension you were receiving from your scheme, subject to a maximum of £26,000 per annum. You were receiving a pension of £600 per week from your scheme which is equivalent to an annual pension of £31,200 (600×52). Your pension was therefore over the annual limit of £26,000 that the GPSF applies. Your compensation will therefore be restricted to £26,000 per year. This is equivalent to £500 per week.

Level of spouse's pension

The GPSF also provides compensation to spouses of members covered by the scheme. This compensation is paid to your spouse after your death. The level of compensation is half the level of compensation that is paid to eligible pensioners. So, for example, were you to die shortly after your compensation payments had started then your wife would be entitled to continue receiving compensation but at a reduced level of £250 per week (half of £500).

Increases granted to compensation payments

The GPSF provides guaranteed increases to compensation payments once in payment. These increases are awarded on an annual basis and are equal to the lower of 2% or the annual increase in prices. This is less than the 3% per annum increases that you receive from the Scheme.

In summary, you are eligible to receive compensation payments from the GPSF that will replace your pension from the XYZ Pension Scheme. These payments will start at £500 per week and will receive annual increases of up to 2%. Your wife will also be eligible to receive payments on your death of one half of the level that you are receiving at that time.

Additional information regarding your benefits from the GPSF can be found on www.GPSFonline.org. Alternatively, please contact me at the above address if you have any further questions.

Yours sincerely,

Mr Hughes

Comments on question 2

Question 2

Candidates were asked to write a memo to a new manager appointed to the annuities department describing the range of products offered and to comment on mortality improvements and historical changes in annuity rates. As in Question 1, a student had written some over-technical briefing notes which it was anticipated that candidates would draw on.

The question contained a lot of information, which candidates were expected to use when giving examples.

- 1. Most scripts had an appropriate introduction, although a minority spoilt this with an inappropriate over-friendly tone.*
- 2. It was recognised that a wide range of approaches could be adopted in answering the question. There was a great variation in the quality of the answers. There were examples both of too little and too much information being included.*
- 3. Better scripts described the range of annuities in simple fashion and tended to give examples of the impact of the various options such as guarantees, spouse's provision and pension increases at each stage.*
- 4. Many scripts described the range of annuity options over several paragraphs without providing any figures or examples, instead opting to set out all the figures together in a table in the middle of their answer. The latter approach suffered if the subsequent table contained a lot of figures apparently just lumped in the middle of an answer without any additional explanation. The approach of containing figures in a separate table some way from the text gained more marks if examples and comments were drawn from the table. Simple diagrams that illustrated the points made also gained marks.*
- 5. The better scripts included comment on the relative impact of the options selected by a policyholder.*
- 6. The better scripts gave a concise description of mortality improvements and contained a graph or table showing the historical decline in annuity rates.*
- 7. Candidates were given a steer in the question to concentrate on four particular areas in their answer. Not all candidates used this information and therefore lost marks.*
- 8. There was evidence of candidates wasting time redrafting scripts and leaving these unfinished without any direction to the examiners to go back and mark an earlier version. The examiners are looking for legible scripts rather than perfectly neat answers, and therefore candidates who prefer to write several drafts need to be mindful of time management.*
- 9. The guideline length was 500 words. Scripts which were below 450 words generally missed out some of the explanation. Scripts which were longer than 550 often lost marks for including unnecessary repetition or irrelevant detail.*

A possible solution is attached. It is not intended to be a model solution. In practice a wide range of solutions was acceptable.

Solution to question 2

Memo to: Bill Brown
From: John Jones

Re: Annuities and the impact of people living longer

As requested, this memo provides some brief information on our annuities. I will look at:

- what is an annuity
- different types of annuity
- the impact of people living longer
- the decline in historic annuity rates

What is an annuity?

An annuity is a promise to pay an income. The simplest annuity is a level payment throughout the life of a policyholder. For a male aged 65 with £100,000 to invest, we currently pay around £650 every month for the rest of their life. For a female the amount would be around £600 – lower, since females live longer so we expect to make more payments.

Different varieties of annuity

There are many ways in which the simple annuity can be adapted. The most common ones are:

- When it is paid – most annuities are paid monthly, but some are quarterly or annual.
- Guarantees – customers can choose to include a guarantee period – typically five years. This means that the first five years' payments are guaranteed, even if the policyholder dies. This has only a small impact on the annuity.
- Spouse's pensions – a customer may want a pension to continue to be paid to a spouse after they die. As payments would be expected to last for longer the annual income offered would be lower. For example, for the male customer above, £100,000 would buy him a monthly income of £580 for the rest of his life continuing at £290 (ie half-rate) whilst his wife is alive.
- Increases – the policyholder can opt for their income to grow every year. We offer annuities increasing annually at 3% or in line with price inflation. Increasing payments are more expensive to provide than non-increasing therefore the starting income is lower. Taking the example above, the monthly income of £580 would reduce substantially to around £400 if annual increases of 3% increases were included. It would then take around 13 years to overtake an annuity with no increases.

Impact of people living longer and decline in historic rates

As you know, people are living longer and we assume that every 15 years into the future, life expectancy will increase further by one year. For example, we expect a 65 year-old male today to live for around another 22 years. However, for a male who reaches age 65 in 15 years' time, we would expect him to live for a further 23 years.

The impact of this is that we will have to pay out for longer, and hence annuities will get more expensive over time. Annuity rates have already declined considerably over the years – £100,000 now buys less than half what it did in 1990. As well as people living longer, the decline has also been caused by lower interest rates, since at lower interest rates annuities become more expensive.

Summary

In summary, an annuity is an income for life. Options including guarantees, spouse's pension, and increases would reduce the initial income. In general the income we can offer has fallen over the years due to falling interest rates and increased life expectancy.

Please give me a call if you have any questions.

Regards,

John

END OF EXAMINERS' REPORT