INSTITUTE AND FACULTY OF ACTUARIES

EXAMINERS' REPORT

September 2019

Subject CP1 – Actuarial Practice

Paper Two

Introduction

The Examiners' Report is written by the Chief 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.

Mike Hammer
Chair of the Board of Examiners
September 2019

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

1. The aim of the Actuarial Practice subject is that upon successful completion, the candidate should understand strategic concepts in the management of the business activities of financial institutions and programmes, including the processes for management of the various types of risk faced, and be able to analyse the issues and formulate, justify and present plausible and appropriate solutions to business problems.

2. This subject examines applications in practical situations of the core actuarial techniques and concepts. To perform well in this subject requires good general business awareness and the ability to use common sense in the situations posed, as much as learning the content of the core reading. The candidates who perform best learn, understand and apply the principles rather than memorising the core reading.

3. The examiners set questions that look for candidates to apply the principles specific to the situation set out in the questions, having read the question carefully. Many candidates gain few marks by writing around the subject matter of the question in a more general fashion. Detailed specialist knowledge is not required and nor is very detailed development of particular points.

4. Good candidates demonstrate that they have used the planning time well to understand the breadth of the question and to structure their answer – this is a big advantage in making points clearly and without repetition. This also enables candidates to use the later parts of questions to generate ideas for answers to the earlier parts.

5. Time management is important so that candidates give answers to all questions that are roughly proportionate to the number of marks available.

6. The comments that follow the questions concentrate on areas where candidates could have improved their performance. Candidates approaching the subject for the first time are advised to use these points to aid their revision.

7. Candidates who give well-reasoned points, not in the marking schedule, are awarded marks for doing so.

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

The pass mark for CP1 is assessed over the 2 papers with the pass mark for this session being a combined 55. Paper 1 scored higher than Paper 2 with the average scores being circa 5% different between the papers. This session was generally answered less well than the April session with candidates struggling on areas which required higher order skills OR significant application to the questions being asked – this was similar for both papers with stronger candidates structuring their answers to consider the specifics being asked in the question.

C. Pass Mark

The Pass Mark for this exam was 55

Q1

(i) The purchase offers ABC the opportunity to:

- Expand into a different:
    - Sector [½]
    - Territory [½]
    - Target market [½]
- Increase presence in overseas market e.g. [½]
    - already owns an insurance company in XYZ's country and wishes to gain further market share [½]
    - already owns an insurance company in XYZ's country and market consolidation would remove a competitor in a competitive market [½]
- Enter a market with ready-made economies of scale, strong country brand, good systems and management [1]
- Buy a company at a good price, because it believes it is undervalued and will generate high returns in the future [1]

Other reasons why ABC may purchase XYZ:

- Take advantage of currency movements [1]
- Diversification of risk [1]
- Capital advantages/regulatory arbitrage [½]
- Tax advantages [½]
- Pressure from shareholders [1]
- Recently sold division and wishes to reinvest elsewhere [½]

[Marks available 9½, maximum 5]

(ii) General points:

- Diversification
- Underwriting at the proposal stage
- Claims control procedures
- Management control systems

<u>Diversification</u> [1]

- Lines of business e.g. [½]
    - Age group (18-24, over 65s) [½]
    - Policy type (comprehensive, third-party) [½]
    - Gender (female, male) [½]
    - Number of lives (single, family, groups) [½]
    - Vehicle type (car, motorbike, lorries) [½]
- Geographical areas of business [½]
    - Residence (regions, cities, streets) [½]
    - Travel location (domestic, continent) [½]

- Reinsurance provider [½]
    - Use reciprocal quota share reinsurance [½]

- Investment asset classes e.g. [½]
    - Bonds, Cash [½]

- Investment asses held within a class e.g. [½]
    - Government bonds, Corporate bonds [½]

<u>Underwriting</u> [1]

- Prevents anti-selection [1]

- Enables the insurance company to classify risks into homogenous groups for which a standard premium can be charged [½]
    - A whole range of rating factors is used to determine granular data regarding the risk [½]
    - Ensures that all risks are rated fairly [½]

- Identifies risks for which special terms need to be quoted [½]
    - Insurer may simply decline risks e.g. historic medical conditions [½]

- Helps ensure that actual claim experience not too far from that assumed in the pricing [½]

- Reduces risk of over insurance e.g. [½]
    - Very high level of cover for a policyholder with past driving convictions [½]

<u>Claims control</u> [1]

- Mitigates consequences of a financial risk that has occurred [½]

- Guards against fraudulent or excessive claims [½]

- Costs of implementing and maintaining a control system must be compared with the benefits gained from it [½]

- Minimise expenses associated with investigating the claim [½]

- Introduce a No Claims Discount and/or increase the excess payable [½]

- Tighter policy wording [½]

- Give suitable example linked to the question [½]

<u>Management control</u> [1]

- Data recording [½]
    - Ensure adequate provisions are established for the risks [½]
    - Reduce the operational risks from having poor data [½]

- Accounting and auditing [½]
    - Can't change the risks accepted but enables proper provisions to be established [½]

- Monitoring of liabilities taken on [½]
    - Protects against aggregation of risks of a specific type to an unacceptable level [½]
    - Check business mix is as expected [½]

- Options and guarantees [½]

- Efficient feedback of experience into premium rating and underwriting [½]

- Give suitable example linked to the question [½]

- Reinsurance programme [1]
    - Individual excess of loss to limit single risk exposure [½]
    - Access expertise within the reinsurer [½]
    - Smooths profits [½]

[Marks available 28, maximum 10]

(iii) *Note to markers: answers must comment on why the funding position has* ***worsened****, and not just why it has changed.*

Reasons:

- Interest added on to the deficit [½]

- Poor investment performance of assets [1]
    - Absolute e.g. negative return on equities [½]
    - Relative against the benchmark [½]
    - Change in asset allocation over the period, moving to poor performing assets [½]
    - Poor performing fund manager [½]
    - Mis-match between asset and liability interest rate or inflation risk exposure e.g. poor Liability Driven Investment (LDI) position [1]

- Change in market conditions over the period, placing a higher value on the liabilities [1]

- Actual inflation higher than expected over the period e.g. due to changing government policy [½]

- Increase in future inflation expectation over the period e.g. due to changing government policy [½]

- Actual pension/salary increases granted higher than expected e.g. due to discretion from trustees [1]

- Mortality experience worse than expected (less people dying due to improvements in medical advancements) [1]

- Transfer of liabilities in/out of the scheme on terms worse than expected [½]

- Members exercise options on terms worse than expected e.g. improvement in cash factors over the period not anticipated [1]

- Retrospective improvement in members' benefits e.g. Court judgement on equalisation [½]

- Scheme expenses higher than expected e.g. due to more work required on valuation process [1]

- Contributions paid in over the period are lower than expected [½]

- Change in future assumptions: [1]
  - Reflecting assets with lower expected return [1]
  - Stronger allowance for base mortality and mortality improvements [1]
  - Other demographic assumptions e.g. cash take-up rate at retirement [½]
  - Other demographic assumptions e.g. proportions married [½]
  - Change in methodology e.g. moving from fixed yield to yield curve [1]
  - Scheme decides to strengthen its assumptions [½]
  - Regulatory intervention to strengthen future assumptions [1]

[Marks available 18½ maximum 10]

(iv) General:
It is important to consider the timing of any actions and their expected impact on reducing the

deficit (give suitable example) [1]
Also need to consider whether the expected benefits will outweigh the costs of implementing the actions [½]

Options:

- Increase payments into the scheme [1]
    - May be necessary if 5-year cap is introduced [½]
    - XYZ will need to consider how to finance this: [½]
        - Raise capital from shareholders [½]
        - Sell off division [½]
        - Make redundancies, possibly some of the employees in the scheme [½]
        - Raise premiums for current business [½]
        - Consider structure and timing of payments e.g. immediate, contingent on other events etc [½]
        - Possibility of ABC making the payments as part of the purchase [½]

(maximum 3 marks from the above section)

- Assets
    - Target higher return-seeking assets, but run additional risk if things go wrong [1]
    - Improve level of matching between assets and liabilities – this will reduce the volatility of deficits in the future but also reduces the chance of significant improvements as well [1]
    - Change fund managers to improve returns and/or lower fees [1]

- Assumptions
    - Weaken assumptions to place a lower value on the liabilities [1]
    - Depends if there is additional prudence in original assumptions that can now be removed [1]
    - Regulator may not allow this [1]
    - There may be a prescribed basis that cannot move away from [1]

- Members benefits
    - Remove any discretions or at least ensure they are on a cost neutral basis [1]
    - Encourage members to take options on terms that are beneficial to the scheme e.g. bulk transfers out from DB to DC scheme etc [1]
    - Restructure benefits e.g. remove future pension increases for uplift in pension [1]
      (ensure example is feasible for a scheme closed to future service)
    - Validate data to ensure correct benefits are paid [1]

- De-risking activity

- Purchase Buy-in/Buy Out from an insurance company, assuming good value [1]
- Purchase longevity swap to manage future longevity trends [½]

- General
  - Reduce expenses, e.g. by outsourcing the administration [½]
  - Review scheme rules where appropriate [½]

[Marks available 20, maximum 8]

(v) Risks:

- Insolvency of life insurance company [1]
  - XYZ may have to pick up the pieces if it goes wrong [1]
  - Members worried about security of funds accumulated to date [½]
  - XYZ's regulator may get concerned if the life insurance company becomes insolvent and knock-on impact on XYZ [1]

- Inadequate benefits on retirement [1]
  - Insufficient contributions made in the period up to retirement [1]
  - Members may have to rely on other sources of income [½]
  - XYZ may be pressured to make good any difference [½]
  - XYZ may lose staff if out of line with market practice [½]

- Inadequate investment return [1]
  - 3% pa may be lower than average return from other assets, leading to a lower fund on retirement [½]
  - Minimum return may be lower than inflation [½]
  - Risk of with-profits policy not paying the guaranteed investment return each year [½]

- Poor quality of administration services [1]
  - Members unable to receive their benefits correctly and on time [½]
  - Life insurance company does not invest the contributions correctly [½]
  - Poor service reflects badly on XYZ's choice [½]
  - High charges from life insurer, either borne by members through Annual Management Charge (AMC) or by XYZ [1]
  - Operational risks e.g. fraud [½]

- External factors, with suitable example e.g. change in regulation requires higher contributions from XYZ than anticipated [1]

Note to markers: if candidates approach this question from the member or XYZ perspective rather than the headings above please give credit for the points made –

for example if the candidate talks about XYZ needing to pick up issues on failure of admin then credit could be given in Q.

[Marks available 14½, maximum 7]

Question 1 was generally well answered by most candidates with most building on their answers. The stronger candidates had clearly planned their answers in detail because they were well structured, easy to follow and therefore generally scored well.

(i) Generally well answered

(ii) Most candidates covered a wide range of points here scoring very well.

(iii) Reasonably well answered but only the better candidates covered future assumption changes

(iv) Candidates covered a reasonable range of points that meant they scored well though many commented on changing the benefits inappropriately.

(v) Again reasonable coverage of points provided the candidate understood that XYZ was not directly responsible for the guarantee.

Q2

(i) An actuary should be clear of the brief and/or terms of reference before starting any analysis. [1]

This will include being clear on the type of advice and decisions the actuary is responsible for. [1]

The actuarial control cycle could be applied to evaluate the proposal. [½]

The first stage of the actuarial control cycle is to identify and analyse the risks of the various stakeholders in detail, and to set out clearly the problem from the point of view of each stakeholder. [1]

The second stage is to develop the evaluation of the commercial mortgage proposal. [1]
This will involve:

- examining the risk analysis and propose the risks that are acceptable from those that are required to be avoided, transferred or managed. [1]
- Consideration of the implications of the risks accepted, avoided, transferred or managed should be undertaken for all stakeholders [1]
- A proposal for the risk appetite for commercial mortgages should be developed [½]
- Consideration of alternative risk appetites and their effects on the commercial mortgage proposal should be set out. [½]
- The proposed risk appetite, and alternatives should be communicated to the stakeholder(s) responsible for decision making. [1]
- The stakeholders through their decisions and feedback on the proposal will drive a feedback loop to refine the proposal and risk appetite. [1]

[Marks available 9½, maximum 5]

(ii) A commercial mortgage is an investment where the income produced by the property is used to pay interest and any repayment of principal due over the loan. [1]

Any outstanding principal is due to be repaid at the end of the loan period either from the proceeds of the property sale or from refinancing a further loan. [1]

In the event that either the interest or principal is not paid when due then the property value at that point provides security. [1]

The property/SPV owner may use other financial resources available to them to avoid a default on interest or principal payments. [1]

The key risk areas for the risk identification are:

- Commercial mortgage loan
- The property collateral value and income production
- Property owner
- Financial and investment markets i.e. refinance of loan or sale of property

<u>Commercial mortgage loan factors</u> [½]
Loan terms & conditions [½]
Legal risk, including cost and time to exercise rights [½]
Legal environment [½]
Covenant of the borrower [½]
Comparative negotiating strength of lender and borrower [½]
Loan to value (LTV) - principal to collateral value [½]
Debt service coverage ratio (DSCR) – Net income property income [½]
On default, length of period to make a recovery. [½]
On default, need to sell below market price to accelerate sale and property is an illiquid asset [½]

<u>Property collateral value and income production risk factors</u> [½]
Cash flow pattern and drivers [1]
Lease length / structure [½]
Marketability [½]
Location, country and location within country [1]
Property type [½]
Property size and divisibility [½]
External risk to physical property e.g. flood risk affecting demand and property value [1]
Tenant quality, credit rating and trade [1]
Diversification between tenants [½]
Uniqueness e.g. property that has won awards for design [½]
Obsolescence [½]
Cash traps i.e. to meet costs and loan payments during void [½]
Level of vacant property costs [½]
Redevelopment potential [½]
Freehold or leasehold [½]

<u>Property owner</u> [½]

Financial strength [½]
Borrower history and incentives [½]

<u>Financial and investment market risks</u> [½]
Property liquidity risk [½]
Refinancing risk including [½]

- Interest rate risk [½]
- Credit spreads [½]
- Lenders lending requirements [½]
- Loan to Value (LTV) at refinancing [½]
- Debt Service Coverage Ratio (DSCR) at refinancing [½]
- Economic risk [½]
- Potential for rent increases [½]

There are also political risks and operational risks involved as well [2]
(0.5 mark for each risk and 0.5 mark for an example)

[Marks available 27½, maximum 15]

(iii) ***Note to markers: there are many issues that are relevant in both parts (iii) and (iv). Credit can be given if points below are mentioned as part of answer to (iv).***

Stakeholders or other professionals involved in reviewing risks would include:

- Economists – due to exposure to economic risks [1]
- Lawyers – due to presence of legal risks, political risks etc. [1]
- Property valuers – collateral value important [1]
- Credit rating function – financial strength of tenants etc important [1]
- Financial modellers – Need to understand cash flow patterns and effect of voids, cash traps, etc. [1]
- Investment manager – For drivers of lending and refinancing risk etc. [1]
- Investment or Risk committee – Need to evaluate the completeness of investment proposal and decide if the level of risk is acceptable under the risk appetite (or ERM plan) [1½]
- Loan servicers and administrators – Need to check and apply covenants, collect interest/principal, report of status of loan etc. [1]
- Financial and statutory reporting (accountants and actuaries) – Accounting to loan income and loan value, liability discount rates depending on assets [1]
- Auditors – Need to agree accounting treatment [1]
- Chief Risk Officer – due to impact on risks that the company is exposed to [1]
- Commercial property experts – due to the exposure to the commercial property sector [1]
- Regulators – due to the different risks of commercial mortgage loans compared with other assets. Also, the capital requirements may not be adequate for this different risk exposure [1½]
- Board of Directors - to review and approve decisions, and general oversight [1]

[Marks available 15, maximum 7]

(iv) ***Note to markers: there are many issues that are relevant in both parts (iii) and (iv). Credit can be given if points below are mentioned as part of answer to (iii).***

The skills and experience required for commercial mortgages are those for each of the stakeholders from part (iii)

Lawyers

Legal skills are required to draw up the commercial mortgage legal agreements. [1]

To advise of the judicial environment, the laws, regulation, legal system, time and cost of court actions, planning regulations etc. [3]

To review any associated legal documents to the arrangement e.g. tenant lease agreement, third party investment management agreement etc. [1]

To provide a legal opinion of the legal enforceability of the commercial mortgage legal agreement. [1]

Property valuers/experts

To provide property valuations for the collateral [1]

Provide expertise on the drivers of property valuations in both normal conditions and under stressed conditions. [1]

Provide expertise on how and when property valuation bases change, for example when is a property valued based on tenant leases versus vacant possession [1]

To advise on void lengths and costs [1]

To advise on length of time and costs involved if property needs to be sold e.g. on commercial mortgage default. [1]

To provide expertise to workout distressed and defaulted commercial mortgages costs effectively and efficiently, reduce length of time to make recovery and optimising recovery rates. [1½]

Credit rating

To provide credit rating for the commercial mortgage. This will influence the yield priced at inception and market values at other times. [1½]

Financial and capital modellers

Commercial mortgages are influenced by large number of risk factors. There may be multiple tenants, properties, complex lease structures etc. Financial modellers can construct models to help analysis and understanding given the complexity. [1½]

To design and calibrate capital models for commercial mortgages. To calculate economic and statutory capital requirements. [1]

Economists

To provide analysis and advice on short to medium term economic risks and potential consequences. Economic models are calibrated based on past experience and in the real world, especially short and medium term or unusual conditions they may be unreliable.[1½]

Loan services and administrators
To set up and operate the loan servicing requirements. This includes checking loan covenants continue to be satisfied, organising inspections and valuations of collateral etc. [1½]

Investment manager
To source commercial mortgages, underwrite them, negotiate terms etc. On-going management of the assets etc. [1]

Investment or risk committee
To provide decision making and management oversight for the commercial mortgage investment proposition. [1]

Auditors and risk management
To manage and review the effectiveness systems and controls on both historical and prospective bases. [1]

Chief Risk Officer
To ensure that the risks taken do not impact on Life Co's other business and reduce possible correlation of risk with other products. [1]

Regulators
To protect policyholders from excessive risk being taken by Life Co, enforcing capital requirements. [1]

Board of Directors
They have ultimate responsibility for the company, its policyholders and its shareholders. They will influence the overall risk appetite of the company. [1]

[Marks available 25 ½, maximum 11]

(v) As set out in part vi) there are a very large range of skills and experience required to invest in commercial mortgages. [1]

There are significant costs and time in setting up teams with all the skills and experience required. [1]

Direct management of assets would give more control over the specific commercial mortgage loans made. It will be exposed to additional risks arising from the external investment managers such as people, systems and processes. [1]

This would delay period before it would take to start investing in commercial mortgages.[1]

Whilst investing £1bn in commercial mortgages may sound a lot an average of £25m per commercial mortgage would still only be 40 loans which is a small number of assets. [1]

The high fixed overheads for a small number of loans and delays in starting to invest in commercial mortgages is likely to make it not only more cost effective, but also time efficient to use an external investment manager with economies of scale. [1]

Further once it has invested the full £1bn there would be a much lower requirement to source further commercial mortgages. [1]

Further advantages are:

- Diversification – exposure to a wider range of commercial mortgages by co-lending rather than 100% of smaller mortgages. [½]
- Can select an investment manager with a proven track record. [½]
- Lower key person risk [½]
- Manager will have a reputation which can help source lending from borrowers. [½]

Even a third-party manager may not have sufficient size to carry out all aspects internally. For example, external legal work, aspects of defaulted commercial mortgage work out. [1]

Use of a third-party investment manager does not remove the need for commercial mortgage expertise. Life Co still needs to:

- Carry out initial due diligence on the investment manager [1]
- Set a risk appetite and investment mandate [1]
- Carry out on-going oversight and review of the investment manager and the asset held [1]
- Set up capital models and calibrations for economic and statutory capital [½]

[Marks available 13½, maximum 6]

(vi) ***Note to markers: IF candidates cover general points then credit should be given, e.g. if candidates say that the length of all loans are suitable for the annuity portfolio then credit should be given under A, I and T.***

<u>Loan A</u>

- The term of loan is likely to be suitable within a portfolio of assets for immediate annuities. [½]
- Largest of the three loans, would represent 6% of planned commercial mortgage exposure, 0.4% of total assets, 3% of surplus assets. Gives highest concentration risk, but still only 3% of surplus assets. [1]
- There is a financially strong tenant so there is a lower likelihood of the commercial mortgage interest not being paid. The lease is longer than the mortgage term. [1½]
- The tenant is responsible for all taxes, repairs, maintenance etc. This risk transfer reduces the risk of unexpected costs from the property. [½]

However:

- There are clear signs that Company R is facing challenges with this office; higher salary costs, recruitment difficulties. [1]
- Company R is not dependent on this office. There is a significant risk that Company R will not renew the risk in 14 years. Smooth office relocations have a long lead time, so in 10 years it may be public knowledge that Company R will not renew the lease. [1½]
- This is a larger office in a poor location which will make reletting the office much more difficult. Further, buildings that have previously won awards for design and architecture are at increased risk of having future development restrictions and changes. This would complicate alternative uses. [1½]
- At the point of refinancing there is a significant likelihood of known future void, on a large office in a poor location, that will be difficult to re-let and has significant risks on redevelopment and alternative uses. This all indicates there is a higher risk of default at refinancing as even sale of the property would be difficult and the value may be inadequate given even at this point the LTV is 75%. [2½]
- This appears a high-risk investment, at a low yield compared with the others. [1]

- The large repayments at the end of the loan gives rise to additional liquidity risk for the insurance company given the risk of default at maturity. [½]

<u>Loan B</u>

- This loan has the same term as loan A and appears suitable as part of a balanced portfolio to back annuity business. [½]
- The initial LTV is 50%, lower than Loan A and represents a smaller investment. [1]
- A downside of this loan is that 40% of the £100m loan is a minority so in a workout it would not have control. However, if the investment manager manages the whole £100m across clients this is less of an issue. [1]
- The commercial mortgage interest cost is £5m p.a. and the current income is £10m p.a. so there is 200% debt service coverage. [1]
- A lease with upward only rent reviews is expected is expect of increase the debt service coverage further, providing further lender protection. [1]

The tenant is responsible for all taxes, repairs, maintenance etc. This risk transfer reduces the risk of unexpected costs from the property. [1]

- The tenant has a lower credit rating; therefore, the void risk is higher. [1]
- The property cash reserve is expected to be up to £20m in a year. Even if there is a void, commercial mortgage interest and void costs can meet for a significant period. [1]
- The high debt service coverage ratio provides protection that a re-let at a lower rent, for example during a recession then would still be sufficient to meet the commercial mortgage interest and rebuild the cash reserve. [1]
- Further a major city centre is a prime location and likely to remain so in 10 years at refinancing. [1]
- Refinancing risk is still significant for this property. There is only a short lease remaining after 10 years and refinancing itself has a reasonably long lead time. The

tenant credit rating could also have worsened. However, with a high LTV the property owner would prefer an orderly sale to maximise its net value after repaying the loan. [1½]

- Overall take account of the risks and yield this appears a preferable investment to loan A. [½]
- The large repayment at the end of the loan gives risk to additional liquidity risk for the insurance company given the risk of default at maturity [½]

Loan C

- This loan has a longer total term than the others, however, it is fully amortising and with a 15-year term appropriate to back immediate annuities. [1]
- No large repayment at end of the loan means the insurance company's liquidity risk on late payment is lower [½]
- The LTV is lower at 40% compared to 50% for loan B. Commercial properties are subject to a higher rate dilapidation, so a lower LTV is reasonable with the fully amortising loan reducing the LTV over the term. [1½]
- LifeCo has 100% of the loan C compared to 40% under loan B which gives greater control if the loan becomes distressed or defaults and has to be worked out. [½]
- The location is good for distribution warehouses so there is likely to be good demand to re-let if there is a void. [½]
- Company W has the lowest credit rating so default and void likelihood is higher. [1]
- However, the current income is £9m across the three warehouses and the interest cost £2.8m. So even allowing for void costs provided two warehouses are occupied the loan interest should continue to be met. [1]
- There is no refinancing risk a significant advantage over loans A and B. [1]

Conclusion

- Give 0.5 marks for an overall conclusion, with another 0.5 marks with the reasoning for this conclusion [1]

[Marks available 31½, maximum 16]

This question was answered less well compared to Question 1 with only the stronger candidates focusing on the specifics of the question. It was clear that the stronger candidates had spent the reading time focusing on the specifics of the question because the answers well structured.

i) Candidates mainly focused on general project evaluation – cashflows or NPV and therefore did not go into sufficient depth to score the marks available for the question.
ii) Not enough candidates focused on the details of the specific asset e.g. terms of the loans themselves or determining the quality of the collateral. Most covered things briefly and in general e.g. credit risk if the tenant defaults but not going into detail about factors that influence the chance of default. Not many candidates commented on refinancing in any detail
iii) Most covered a wide range of stakeholder
iv) but candidates then struggled with providing details of the skills required. Many focused on general points such as having required qualifications, being professional and then replicated the same point for each of the stakeholders.
Examiners gave credit if candidate answered parts (iii) and (iv) together and explained in detail each of the stakeholders.
v) Very few candidates went into sufficient depth/breadth to score well on this part of the paper.
vi)Many candidates had a reasonable attempt though the weaker candidates did not explain their points enough. Many candidates did not focus on the specifics of each mortgage and the issues/benefits for the annuity funds. Examiners were surprised that candidates didn't go into reasons why certain features were suitable/not suitable for the annuity fund – e.g. the mortgages are long term with no reasons why this was good meant only partial credit could be given. Very few candidates gave a conclusion

END OF EXAMINERS' REPORT