

EXAMINATION

6 October 2010 (pm)

Subject SA5 — Finance Specialist Applications

Time allowed: Three hours

INSTRUCTIONS TO THE CANDIDATE

1. *Enter all the candidate and examination details as requested on the front of your answer booklet.*
2. *You have 15 minutes before 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.*
3. *You must not start writing your answers in the booklet until instructed to do so by the supervisor.*
4. *Mark allocations are shown in brackets.*
5. *Attempt all three questions, beginning your answer to each question on a separate sheet.*
6. *Candidates should show calculations where this is appropriate.*

AT THE END OF THE EXAMINATION

Hand in BOTH your answer booklet, with any additional sheets firmly attached, and this question paper.

<p><i>In addition to this paper you should have available the 2002 edition of the Formulae and Tables and your own electronic calculator from the approved list.</i></p>
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1 A general insurance company intends to develop a new computer mainframe system for storing policy details in order to replace its current system. The company's IT is outsourced to a third party. You have been asked to act as the risk process manager for the project.

(i) (a) Describe what your role would involve and how you would undertake the risk assessment process.

(b) Outline the difficulties you may encounter and how you may resolve them.

[12]

(ii) (a) Outline the likely content of your project close-down report.

(b) State which of the project participants you would expect to discuss your report with.

[4]

The weighted average cost of capital for the firm is 8%.

(iii) Explain why this rate may not be appropriate as the discount rate to use when evaluating whether the project should proceed. [3]

(iv) State five operational risks associated with this project and for each suggest a way of mitigating this risk. [5]

(v) (a) Outline how you would apply the loss distribution approach to modelling the expected cost of operational risks.

(b) Describe how you would validate your model using a risk that you have identified in (iv) as an example.

[10]

[Total 34]

2 (i) List the key features of a Public Private Partnership. [2]

(ii) Describe the process a country would go through to decide whether a Public Private Partnership is cost effective. [3]

A country intends to install a new computer system for its health service. The country intends to finance the project through a Public Private Partnership. The initial cost of the project is estimated to be \$500m. The country's health service is willing to pay an estimated \$80m per annum for the new system providing it is fully operational. The social benefits of the new service are estimated to be \$50m per annum.

(iii) Outline how you would determine the amount of initial investment that would be acceptable to each partner. [5]

(iv) Suggest other factors that may affect the decision of either partner as to the investment they are prepared to make. [6]

[Total 16]

- 3** Mr Makemoney recently started a small new UK fund management firm called Credit World Asset Management (CWAM). Mr Makemoney proposes to launch his first fund which will be marketed to both high net worth individuals and institutional clients.

The fund's aim is to build a portfolio of various types of non-government debt instruments from around the world. The fund will initially focus on investing in debt issued by companies in a small number of industries and from selected countries. The fund will be authorised to invest both long and short and to obtain credit exposure through both physical investments in cash markets and synthetically in derivative markets.

Previously, Mr Makemoney has only had experience trading derivative securities that were cleared through the London Clearing House (LCH).

- (i) Describe the role of the LCH. [6]
- (ii) Explain how the various credit risks of the fund's portfolio could be managed better by using instruments or trades that are not currently cleared through the LCH. [6]
- (iii) Describe the product risks facing CWAM when both setting up and managing the fund. Your answer should cover product definition, development, technical considerations, counterparties and outside resources, quality and legal, and sales. [12]
- (iv) Discuss ways in which CWAM could manage or mitigate the product risks identified in (iii). [12]
- (v) Outline the FSA's methods of operation and its enforcement regime, including the disciplinary actions it could impose on CWAM and its management. [7]

You have been asked to produce a plan to safeguard CWAM from a major influenza outbreak amongst staff.

- (vi) Describe the measures which could be taken to ensure the business could operate efficiently during such an outbreak. [7]
- [Total 50]

END OF PAPER