INSTITUTE AND FACULTY OF ACTUARIES

EXAMINATION

30 April 2015 (am)

Subject SA6 – Investment 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 new page.*

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.

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.

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1 (i) Describe what is meant by Quantitative Easing. [5]

(ii) Explain why Quantitative Easing might result in rising asset prices. [6]

Following a severe recession in a developed country, the Central Bank initiated a policy of Quantitative Easing to stimulate the economy and to revive economic growth.

Several years later, following a gradual if uneven recovery in economic growth, the Central Bank has begun to taper (wind down) its Quantitative Easing programme and is expected to end the programme in the next six months.

(iii) Discuss the likely impact of the change in monetary policy on:

(a) the domestic bond market.
(b) the domestic equity market.
(c) the country's exchange rate.
(d) domestic economic growth.
(e) domestic inflation.

[25]
[Total 36]

2 (i) State the factors that should be considered when designing an investment portfolio for a liability driven investor. [5]

(ii) (a) List two types of investors who would not normally be considered to be liability driven.

(b) Outline why each of the above investors could be considered to be less constrained than other investors.

[5]

The national government of a large developed country has announced that it is considering consolidating a large number of public sector pension funds into a single pension fund. Its aim is to raise governance standards and reduce costs through increased economies of scale and greater use of passive management where appropriate. The draft investment guidelines require at least 80% of assets in domestic equities and bonds to be managed passively in line with a market capitalisation or customised index. The government has undertaken a consultation exercise to seek responses from a number of industry bodies.

The chairman of an industry body promoting the interests of active investment managers has asked the body's investment actuary to draft a response to the government's announcement. The purpose of the response is to highlight the benefits of active management to the wider economy and to investors including public sector pension funds, who own approximately 20% of the domestic equity and bond markets.

(iii) Set out the points the industry body's actuary should include in his report.
[14]

Following the consultation exercise an investment actuary within the government's policy department has been asked to consider two alternative proposals to the original proposal that would help achieve governance improvements and greater economies of scale:

- a centralised procurement process for all existing and new manager appointments
- setting up a common investment fund for each asset class

The investment actuary has been asked to describe each approach and comment on the extent to which it achieves the government's objectives relative to the original proposal.

(iv) Set out the points the government's investment actuary might include in her report. [10]

[Total 34]

3 A new technology company has successfully used modern innovative business strategies and is now firmly established and growing rapidly. In order to apply a similar innovative approach to the benefits that it provides for its employees, the company established a non-pension defined contribution (DC) savings scheme for its employees five years ago.

The workforce is relatively young with an average age of 25. Given its entrepreneurial and innovative spirit, the company is investing all savings scheme contributions into a newly established hedge fund. The hedge fund manager was given a broad mandate to invest in "good long term assets".

The hedge fund manager has invested in a combination of:

- equities (quoted and unquoted)
- corporate bonds (quoted and unquoted)
- property; and
- venture capital funds (mostly unquoted).

The trustees of the savings scheme have employed an actuary as an investment advisor. The hedge fund manager has provided them with detailed statistics and reports on the performance of the hedge fund. The trustees have asked the actuary to comment on the performance statistics of the hedge fund.

(i) Discuss the factors which the actuary should consider in order to comment on the performance statistics of the hedge fund. [11]

The trustee board has appointed a new chair who has raised concerns about the suitability of the hedge fund for the savings scheme.

(ii) Discuss the factors to consider for the purposes of assessing the hedge fund's suitability for an investment by a DC savings scheme. In your answer you should consider the following:

- the appropriateness of the investment
- the key personnel within the hedge fund management team
- governance within the hedge fund management team
- the quality of the hedge fund's business
- any other relevant issues.

[19]
[Total 30]

END OF PAPER