

Actuarial Society of South Africa

EXAMINATION

19 May 2014

Subject A302 — Communications

EXAMINERS' REPORT

General Examiners' Comments

This report summarises the main points that the examiners were looking for and some common problems encountered.

Question 1

Candidates were asked to draft an email to a colleague explaining why the pension quotation was lower. There were three key reasons why the pension did not increase:

- Improved mortality;
- Lower interest rates; and
- Introduction of a guarantee period.

1. Although most candidates succeeded at this identifying the reasons behind the lower quote, a number were let down by their tone. Some were overly formal, adopting a tone that would have been more appropriate for a client (instead of a colleague), while others were too informal. Candidates were expected to adopt a tone that not only demonstrated familiarity with the recipient, but also professional.
2. The better scripts had an opening paragraph that demonstrated understanding that the colleague could quite reasonably have expected an increase in pension. Some candidates lost marks for simply referring to an email received without stating the nature of the colleague's query or stating the figures that were being queried.
3. Some candidates lost marks because their email seemed to be theoretical, e.g. by talking about 'the pensioner' as if they were someone different to the addressee of the email, or referring to a pension of RX per month instead of quoting the figures applicable to the colleague.
4. A significant number of scripts included words of jargon. Words such as 'longevity' and 'mortality' and phrases such as 'asset allocation/mix', 'bond yields', 'market conditions/state of the market' and 'risky investments' were unlikely to have been understood. Candidates must note that they cannot assume that words that are in the question do not constitute jargon.
5. A number of candidates lost marks due to explanations that were technically inaccurate, or accurate but not relevant for meeting the objective of explaining the lower pension quote, whether explicitly or implicitly, and therefore misleading. The following are examples:
 - The legislated guarantee period was anything between 5 years and 10 years. Some candidates suggested that the prescribed period was 5 years.
 - The company was not the provider of pensions at retirement. The pension fund would be used at retirement to buy a pension from an insurer. Some candidates even

described living annuities and suggested that the fund would remain invested and the pension would be drawn from the fund and there was a risk of running out of funds. Some scripts left the colleague with the impression that if they lived beyond the expected lifetime, their pension would cease.

- The main impact of lower interest rates is that it led to lower annuity income. The impact of lower interest rates on the fund growth did not aid explaining why the second quote was lower, particularly in the absence of knowledge of the asset mix on the colleague's fund.
 - Introducing equity returns in the explanation – there is no direct link between annuity rates and equity returns and introduction of equity returns did more to confuse the colleague.
6. A number of candidates did not mention the role of AIDS in improved mortality. A small number left out mortality improvements completely.
 7. Whilst most candidates did mention the guarantee period as one the reasons why the pension quote was lower, a number failed to explain how this led to a lower pension.
 8. Better candidates made good use of headings and paragraphs. However some candidates lost marks because their headings were not relevant or were excessively long. Marks were also lost if there were headings for the opening sections and then no headings for later sections.
 9. A number of candidates lost marks because the main purpose of the email was devalued by the focus on minor points or irrelevancies, such as descriptions of how the colleague could change contribution levels, or asset allocations.

Question 2

Candidates were asked to draft a leaflet to members of a teachers' union, representing Union Life yet presenting both the Union and the government in a positive light.

1. Most candidates managed to cover all the key features of the scheme and linked it to Union Life's product offering. A disappointing number of students focused on presenting the facts without focusing on presenting it as a leaflet. A number of scripts were written more as a fact sheets than leaflets with little or no attempt to encourage the members to take part in the scheme with the focus merely on summarising the key features of the scheme and the products.
2. It was important to identify the key players in the introduction, i.e. the government, Union Life and Allied Teachers' Union. The link between these three was not well

addressed by some candidates. In some cases there was no mention of the Allied Teachers' Union at all.

3. The better candidates managed to include tables and/or graphs in their scripts. Unfortunately some graphs were technically inaccurate, showing the repayment profile of a repayment mortgage as a straight line, for example.
4. Most candidates struggled to keep the leaflet within the required word count. Some of the reasons behind this were:
 - Inclusion of products that were not relevant, i.e. annuities and whole of life assurances. Some scripts even suggested using an annuity to pay for insurance premiums, failing to recognise that a customer with enough resources to buy an annuity would, in all likelihood, not require the mortgage.
 - Poor structuring of the leaflet using graphs and tables and merely putting the facts together. This led to some repetition in some scripts.
 - Long winded explanations.
5. Some candidates did not present the leaflet from Union Life's perspective, either presenting from the Union's perspective, or leaving it unclear who they were representing.
6. A number of candidates lost marks by not making the important link between the mortgage and insurance products, and showing how they could be used together.
7. A disappointing number of students failed to highlight the need for a separate savings vehicle for an interest only mortgage, irrespective of the fact that Union Life did not offer these products.
8. Some scripts had a technical tone due to failure to define the products. It was unlikely that the teachers would know the differences between the insurance products without guidance.
9. Some candidates did not include important figures in their scripts, e.g. prime rate of (9%), repo rate (5%).
10. Repo rate/ prime rate were technical words that required careful introduction. Most candidates managed to use these words in a manner that was appropriate for the audience. Phrases such as 'non profit', however, were unlikely to be understood.
11. There were some inaccuracies in some scripts:
 - Implying that the 9% prime rate is offered to all customers without highlighting that it was an indicative rate for the average customer with a good credit record.

- Defining endowment assurances without the death benefit. A number of candidates left out the fact that it also pays out on death during the term and defined a pure endowment instead.

Question 1

Email Marking Schedule

Length: Full marks can be given if range falls within **500 – 550**.

Format: The correspondence should resemble an email, with various fields such as date/time (can be on the left), 'from', 'to', cc, and subject. The format mark also includes a friendly salutation and close. Automatic signature could be added bonus (created or simply alluded to). Marks will be lost if the student does not address the recipient directly.

Language: This section includes choice of words, register/level of language, avoidance of jargon and overly numeric approach, style and tone, grammar, punctuation, spelling etc. A consultative style with courteous, polite tone would be appropriate avoiding overly formal or clichéd touches.

Planning and structure: This involves the use of headings from the subject line to headings in actual letter. Also includes the logical, coherent arrangement of information, good sentence and paragraph structure, good clear use of information without technical formulae etc. as well as good beginning, middle, end conventions: Opening paragraph: goodwill and topic identification; relevant body explanations and close: goodwill once again and pointing the way ahead.

Overall impression: This involves how the email 'hangs together' (content, courtesy and composition) and the overall impression made on receiver i.e. how satisfied would recipient be with this explanation?

Content and objectives

The following points **should** be included:

1. Background information on the query

- Acknowledge the original email from colleague with the query
- Recent quote is R11,000
- Quote from four years ago was R11,250
- Fund growth from R1.4m to R1.8m
- Pension quotation based on publicly available information

2. How long you might live

- Pension will be paid for shorter period
- You are right that it should mean a higher pension
- People are living for longer than previously

- AIDS related improvements are the key driver
- Insurance Industry has updated assumptions to allow for pensions to be paid for longer on average
- Effect is to reduce pensions

3. Guarantee Period

- New legislation came into effect two years ago compelling inclusion of guarantee period in pension illustrations
- Guarantee period must be between 5 and 10 years (not just 5 years)
- Guarantee period means pension will be paid for the minimum period, regardless of how long one lives
- Pension with guarantee is lower than one without a guarantee
- Your recent quote has a five year guarantee period whereas the previous one doesn't

4. Investment Returns

- Interest rates have fallen in the past four years
- Returns on funds backing pension funds have also fallen
- Insurance companies have taken this into account in pension quotations
- Leading to lower pensions compared to four years ago

5. Summary

- Overall effect of the above factors have absorbed the effect of the higher fund and the shorter period
- Provides with opportunity for further queries

The following points **should not** be included.

- Equity markets performance (including the recent bull run)
- Other pension options available
- Colleague experiencing standard mortality (which is also jargon)

The communication meets the recipient's objectives and presents the communicator in a credible fashion.

- Colleague understands why the pension has dropped despite (rightfully) expecting it to be higher
- Mortality has improved
- Inclusion of a guarantee period
- Lower investment returns

Question 1 Email Sample Solution

From: Tebogo Letsoalo <Tebogo.Letsoalo@JoburgMin.co.za>
To: Leandre Van der Meulen <Leandre.VanderMeulen@JoburgMin.co.za>
cc:
Subject: **Pension Quote Query**

[can add date and time or allude to it on the left]

Dear Paula

Thank you for your email in which you queried your recent pension quotation. You were concerned that you were quoted a pension of R11,000, which is slightly lower than the R11,250 you were quoted four years ago. This is despite the fact that your pension fund has grown from R1.4m to R1.8m and you are now older.

I'll firstly look at the factors affecting how the pension is calculated and then look at how these factors have changed over the four-year period.

Calculating Your Pension

The pension you get for each R1 of pension fund quoted in the Financial Gazette depends on the following major factors:

- How long you might live,
- Guarantee period, i.e. a minimum period that the pension is paid irrespective of how long you live, and
- What rate of investment return can be obtained.

Looking at these in turn:

How Long You *Might* Live

As you have correctly pointed out, your pension will be payable for a shorter period than had it commenced four years ago. You therefore, quite reasonably, expect that you should get more pension for every R1 of your pension fund.

However, an analysis of how long people are living has shown that people are living for longer than was previously expected. This is due to improvements in medicine, particularly AIDS-related treatments. Insurance companies have therefore reviewed their pension

calculations to reflect this. This has reduced the amount of pension for a similar pension compared to four years ago.

Minimum Guarantee Period

New legislation that became effective two years ago compels us to include a guarantee period of between 5 and 10 years in all our quotations. The effect of the guarantee period is that the pension will continue to be paid until the end of the guarantee period, irrespective of how long you live. A pension with a guarantee therefore pays less than an equivalent pension without a guarantee period.

Your recent quote includes a five year guarantee period, whereas the quote from four years ago does not.

Investment Returns

As you may be aware, interest rates for savings accounts have fallen over the last few years. Similarly, the investment returns have also been reducing. The money that insurance companies invest in your pension fund in order to pay your pension will therefore get a lower investment return than had it been invested four years ago. A lower expected return means a lower pension can also be paid from your pension fund.

The pension quotation has also been updated to take account of the lower expected investment returns. This has further reduced the amount of pension offered for each R1 of pension fund.

Summary

Your pension quotation has been affected by three factors:

1. People are now living longer;
2. The recent quotation includes a guarantee period of five years, and
3. Investment returns are lower.

Taken together, these factors have fully absorbed the growth of your fund over the past four years and the shorter period that the pension will be paid.

Please call me on extension 2580 or email me if you have any further questions.

Regards

Tebogo

<Automatic Signature>

(525 words)

Question 2

Leaflet Marking Schedule

Length: Full marks can be given if range falls within **500 – 550**.

Format: This is the content of a leaflet which will be used to inform teachers (a lay audience). Marks are available for appropriate use of paragraphing, and creating a design that would be appealing in terms of font (type and size), bold for headings etc. (the *extrinsic* aspects of structure and layout). i.e. what does the leaflet actually look like?

Language and tone: This section includes choice of words, register/level of language, avoidance of jargon, style and tone etc. It is important that the leaflet is written in an accessible tone to appeal to the audience (primary and secondary school teachers). The language used should be jargon free and aim to explain the concepts clearly and simply. The tone should be a careful balance between purpose to inform, persuade and to build personal rapport. The persuasion to join the scheme should be based on fact and be perceived as courteous, reassuring and expert. Technical details must be clearly explained so that the scheme, the products and how they can be used together are understood by the teachers. The leaflet should give the background to the scheme and clearly explain the product features in a way that shows how they can be applied under the alternative mortgage options. Using terms such as 'you' in the leaflet is appropriate so that the reader feels that (s)he is being addressed personally. However, a professional approach is still required, which is not familiar or colloquial as readers still strangers and this is a professional exchange.

Planning and structure: The opening should be interesting enough for reader to continue. The facts must be set out in a logical and coherent arrangement. How the leaflet progresses through the different concepts must aid the explanation of the government scheme, the mortgage options and Union Life's (appropriate) products. Any tables and/or graphs must be clear. Internal arrangements of fact: description/definition, explanation, comparison and contrast. The explanation must not jump around too much in a manner that will cause confusion. Any tables/graphs must be clearly embedded (lead-in) and add value to the leaflet. This section is more about the *intrinsic* aspects of structure.

Overall impression: How does the leaflet 'hang' together in terms of unity, coherence and emphasis, logical development, and overall structure of message? Do all the elements above work together to create a good understanding of the product? Would the reader be able to make sense of it and would this type of document allow for more informed decisions?

Content and objectives

The following points **should** be included:

1. Background Information

- Existence of government scheme (explicitly as introduction)
- Eligibility of all union members

2. Mechanics of the scheme

- Preferential rates on mortgages
 - Currently 5%
 - Compared to 9% prime
 - Prime is benchmark rate for banks
- Term of 20 years or retirement if earlier than 20 years
- Premium discounts on Union Life's complimentary products
- No penalties for early redemption
- Transfer duties waived for mortgages of less than R1.5m

3. Mortgage Options

- Interest-Only mortgage
 - Definition – only services interest on the capital
 - Initial loan needs to be paid at the end of the term
 - Separate savings vehicle required to pay off mortgage at end of term
- Repayment mortgage
 - Both interest and capital paid during the term of the mortgage
 - Mortgage fully paid off at end of term
- Graphical Illustration

4. Appropriate products that Union Life Offers

- Level Term Assurance – same amount paid on death
- Decreasing Term Assurance – decreasing sum assured paid on death
- Endowment Assurance – sum assured paid on death or survival to end of term

5. Combining the Products with the Mortgages

- Level TA – interest only mortgage
 - Separate savings vehicle still required (if not already covered under interest only mortgage section above)
- Decreasing TA – repayment mortgage
 - Sum Assured profile set to match the outstanding balance
- Endowment Assurance – perfect match for interest only mortgage

6. Next steps – existence of full brochure and application forms

The following **should not** be included:

- Including Whole of Life Assurance products
- Savings vehicle options for Interest Only Mortgage option

Would you, as a primary or secondary school teacher, understand the content in non-technical terms?

- How the scheme works and incentives provided
- What mortgage options are available
- What products can I use and how can I combine them with the mortgages

Leaflet Sample Solution

UNION LIFE ASSURANCE

SPECIAL MORTGAGE DEALS FOR THE KEY WORKERS' HOUSING SCHEME

Union Life Assurance is delighted to announce that it will be supporting the government's Key Workers' Housing scheme. The scheme gives you access to preferential rates on mortgages from the government as well discounts on Union Life's products used in conjunction with these mortgages.

All members of the Allied Teachers' Union (ATU) are eligible to join the scheme.

How does the scheme work?

The scheme offers you mortgages at reduced interest rates. The scheme interest rate is currently 5%, which is much lower than the prime rate of 9%, which most banks use as a minimum for their mortgage products. The mortgages will have a term of 20 years or up to retirement age of 65 (if you retire before the end of the 20-year term).

In addition, the government will waive transfer duties for mortgages of up to R1.5 million.

What mortgage options are available?

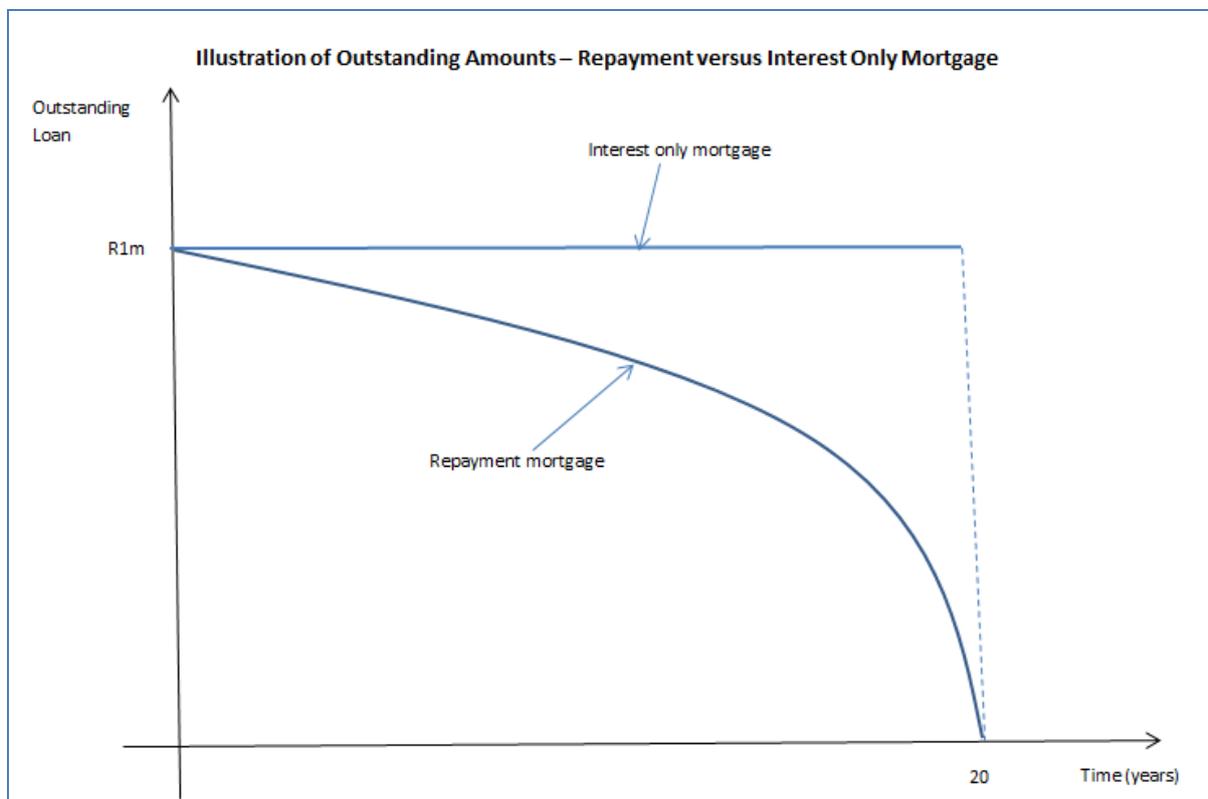
You have two types of mortgages to choose from: interest only mortgage and repayment mortgage.

What are the differences between the two mortgages?

Interest only mortgage - You only need to pay the interest on the mortgage monthly BUT will need a separate savings product to pay off the loan at the end of the term.

Repayment Mortgage - Your monthly repayments comprise both the mortgage borrowed and interest so that the loan is fully repaid at the end of the term.

The graph below shows the outstanding amounts under the two mortgage options for a R1 million mortgage with a term of 20 years:



Union Life’s Products

Union Life has products that will be available at discounted prices to all union members and can be used to complement the mortgages. These are defined below:

Table 1 – Union Life Products

TERM ASSURANCE	<p>If death occurs during the term of the policy, you are paid a defined amount (sum assured).</p> <ul style="list-style-type: none"> • No payment is made if you survive to the end of the term. • Amount can be level or decreasing amount that reduces with the term of the policy.
ENDOWMENT ASSURANCE	<p>It pays out the sum assured at the end of a term or on death during the term.</p>

How are Union Life Products combined with the Mortgages?

You can use Union Life products either for paying off the mortgage in the event of death during the term of the mortgage, or in the case of an EA, for paying off the mortgage at the end of the term as well. The table below summarises how the products can be used under each mortgage option:

Table 2 – Product and Mortgage Option Summary

	Interest Only	Repayment
LEVEL TERM ASSURANCE	<ul style="list-style-type: none"> • Protection against death during the term of the mortgage. • Separate savings product required to pay off loan at the end of the term. 	N/A
DECREASING TERM ASSURANCE	N/A	<ul style="list-style-type: none"> • Protection against death during the term of the mortgage • Sum assured can be set to equal the outstanding loan on the mortgage.
ENDOWMENT ASSURANCE	<ul style="list-style-type: none"> • Perfect match for interest only mortgage. • Mortgage fully paid on death during term or at the end of the term. 	N/A

What Should I Do Next?

If you are interested in joining the scheme, please contact Jacob Nkandla, the ATU liaison officer (extension 1234) who will give you a more detailed booklet which includes application forms.

(549 words)