Actuarial Society of South Africa

EXAMINATION

30 May 2011 (am)

Subject F205 – 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 at 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

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.

Question 1

Two medium-sized life companies are merging. One offers mainly linked investment products while the other has a substantial book of discretionary participation products. In the past both companies' only investments in direct property have been in the form of buildings that they occupy. All other property related investments have been via listed securities.

You are a consultant advising the board of the merged company on asset liability management. The Statutory Actuary of one of the companies suggests that the merged entity will be big enough to warrant investing in direct property occupied by non-associated companies to generate returns for policyholders, a change he strongly supports. The Chief Investment Officer of the merged entity argues that she requires the liquidity of listed property in order to optimise returns.

a) Discuss the implications of direct investment in property from the perspectives of both the Statutory Actuary and the Chief Investment Officer.

[12]

b) Comment on the practical considerations that changing to direct property investment would entail.

[11]

c) State, with reasons and clearly stating any assumptions you make, what approach you would recommend.

[4]

[Total 27]

Question 2

The statutory returns that life companies are required to submit annually to the regulator include detailed questions about the use of derivatives. These include asking if the Board of Directors has approved the use of derivatives, has documented the objectives and policies for their use and monitors their use in line with such objectives and policies.

You have been asked to advise the board of a life office on drafting a policy for the use of derivatives. The policy will be used to formalise governance around the use of derivatives and to assist in addressing the regulator's requirements. It will apply to all assets on the life company's balance sheet.

a) Outline reasons why a life company might invest in derivative instruments during the normal course of its business.

[7]

b) Discuss what stipulations would be appropriate in such a policy.

[17]

c) Describe how the board might monitor compliance with the policy.

[7]

[Total 31]

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Question 3

You are the CIO of a privately owned South African asset management firm, XYZ Asset Managers, with assets under management of R15bn. XYZ classifies itself as a value manager and currently manages the assets of a number of pension funds as well as a range of collective investment schemes. All its current mandates are local only (incorporating South African equity, South African bond and South African money market assets) and it does not have the capability to manage offshore assets.

With the recent relaxation of exchange controls and pension fund prudential investment regulations, XYZ has lost some of its funds under management as its pension fund clients rebalance their portfolios to take advantage of the new regulations allowing increased offshore exposure.

a)

i. Explain the considerations that the trustees of a defined contribution pension fund should take into account when setting the strategic asset allocation for the members' default choice of investment portfolio.

ii. Explain why the trustees of such a fund may decide not to increase the allocation to offshore assets in their default portfolio despite the relaxation of exchange controls.

[12]

The directors of XYZ have requested that you investigate the possibility of setting up an offshore asset management division with the aim of retaining and capturing assets from existing and new pension fund clients that are taking investments offshore in ever greater amounts.

b) Discuss the issues involved and the critical decisions that need to be made in considering this option.

[10]

Another option available to XYZ is to buy an existing firm. In the course of your investigation you come across INT Managers, a London-based asset management firm which manages global equity and bond portfolios. INT's current assets under management are USD 3bn, split evenly between equity and bond portfolios. You have been invited to make an offer to buy the firm from its current owners.

c)

i. Comment on the merits and disadvantages of acquiring the existing firm rather than starting a new one.

ii. Describe how you would carry out a valuation of the business, listing any information you may require, and stating any assumptions you would need to make.

[20]

[TOTAL 42]

