

EXAMINATION

26 May 2014 (am)

Subject F205 – Investment Specialist Applications

Time allowed: Three hours

INSTRUCTIONS TO THE CANDIDATE

- 1. Candidates will be issued with instructions to log-in using a password (which you will be provided with at the exam center).*
- 2. Candidates are required to submit their answers in Word format only using the template provided.*
- 3. Save your work continuously throughout the exam, on your computer's hard drive with which you have been provided.*
- 4. 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.*
- 5. You must not start typing your answers until instructed to do so by the invigilator/supervisor.*
- 6. Mark allocations are shown in brackets on exam papers.*
- 7. Attempt all questions, beginning your answer to each question on a new page.*
- 8. Candidates should show calculations where this is appropriate.*

Note: The Actuarial Society of South Africa will not be held responsible for loss of data where candidates have not followed instructions as set out above.

AT THE END OF THE EXAMINATION

Save your answers on the hard drive.

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

You are the fund manager of a private equity fund based in South Africa that invests in countries in the rest of Africa. You are considering a proposal from a small engineering firm based in a neighbouring country. The firm wishes to expand its operations in a “Frontier” African country that is on an infrastructure spending drive. The firm proposes that the expansion be financed through a rights issue and that your fund invests.

- i) Outline the advantages and disadvantages of investing in unquoted equities. [4]
- ii) Discuss the factors that you would take into account in considering the proposal. [20]
- iii) Describe the measures would you put in place to manage and mitigate the risk of the investment. [4]

[Total 28]

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QUESTION 2

You are advising the trustees of the XYZ Pension Fund on the Fund's investment strategy. The Fund is a South African defined contribution pension fund.

The Fund has adopted a Lifestage investment strategy. The Lifestage framework comprises three portfolios with different risk profiles. These portfolios have the following allocations:

	Growth Portfolio	Moderate Portfolio	Low Risk Pre-retirement Portfolio
Local Equities	60%	55%	27%
Local Bonds	35%	35%	40%
Local Cash	5%	10%	33%

Members' funds are initially invested in the Growth Portfolio. At age 55 they are transferred to the Moderate Portfolio and at age 60 are transferred to the Low Risk Pre-retirement portfolio. Retirement age is 63. No further options are made available to members.

- i) Discuss the limitations inherent in Lifestage investment strategies and recommend solutions to these. [10]

The trustees are debating introducing an allocation to offshore equities in each of the portfolios.

- ii)
- a) Discuss the arguments both for and against introducing offshore equities
- b) Recommend a new allocation, with reasons, for each portfolio. [7]

A particular member is approaching retirement. He noticed that his personal portfolio's value has decreased by over 1% during January 2014. Looking back he also noticed a 2% fall in his portfolio value in June 2013. The member has written to the Fund's Principal Officer demanding an explanation, given that he understood the objective of the Low Risk Pre-retirement Portfolio was to preserve capital for members approaching retirement.

- iii) Explain the reason for the capital loss, putting this into context of global and domestic economic events that have impacted returns since early 2013. [6]

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The Trustees are considering introducing a default annuity option for members retiring from the Fund.

- iv) Briefly describe and list the advantages and disadvantages of the following options:
- a. Fixed Life annuity (with or without fixed increases)
 - b. Living annuity
 - c. Inflation-linked annuity
 - d. With-Profits annuity
- [7]

The trustees have narrowed their options for the default annuity to either an Inflation-linked annuity or a With-Profits annuity provided by a reputable insurer.

- v) Recommend, with reasons, how the investment strategy for the Pre-Retirement Portfolio should be changed (if at all) in order to better protect the level of post-retirement income for each option. [5]
- vi) A trustee has advised that one of the Fund's investment managers, in a report-back, showed them a graph of the South African Volatility Index (SAVI). The trustee has asked for more information on the SAVI.
- a) Explain what the SAVI represents and how the index should be interpreted.
 - b) Describe the potential uses to an institutional investor of SAVI as an indicator, as well as the derivative instruments based on it.

[6]

[Total 41]

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QUESTION 3

You are a manager of a hedge fund of funds that invests across of variety of strategies. A large potential private investor is interested in your fund but is unsure of whether to invest in a single multi-strategy hedge fund or a hedge fund of funds like yours.

- i) Outline the advantages and disadvantages of a hedge fund of funds relative to a multi strategy hedge fund. [4]

The investor would like to understand how your fund decides which hedge funds to invest in.

- ii) Explain what factors should be taken into account in selecting which underlying hedge funds to invest in. [7]

The investor is further concerned that the lack of regulation in the hedge fund industry at large in South Africa will mean that investors have no way of managing their risk.

- iii) Outline the arguments you would make in responding to the investor's concern given the current South African regulation of hedge funds. Include reference to the following in your answer:
- a) The current regulatory environment, outlining the relevant gaps in regulation.
 - b) Risk measurement and mitigation mechanisms available to the investor. [9]

The regulator has issued a call for comment on regulatory reform in the hedge fund industry.

- iv) Outline regulatory reforms that would be necessary for the South African market. [11]

[Total 31]

[Total 100]

END OF EXAMINATION