A picture containing company name

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Core Unit 4

Financing and Investing for Retirement Provision

Mock Examination

Recommended Time: 2 hours

1. **Alpha and Beta are two terms commonly used to judge active investment manager performance. Explain the meaning of these terms and state what levels of alpha and beta a trustee would typically prefer.**

**5 marks**

Relevant section of the manual is Part 6 Chapter 1.1.

Format: description

Answer should cover. For each approach:

* Trustee typically prefers high Alpha and low Beta
* Alpha: Measure of investment performance compared to a benchmark

Manager seeks to provide alpha through good stock selection to outperform the passive manager

* Beta: Measure of volatility compared with the market

Portfolio with a low Beta has less asset volatility than one with a high Beta

1. **Describe how investment professionals assess whether a company’s share price is reasonable and outline the most common methods of valuing the shares.**

**20 marks**

Relevant section of the manual is Part 2 Chapter 1.4.

Format: descriptive

Answer should cover short description of:

* The company information against which they evaluate the share price
* Return on investment capital - profits divided by the amount of capital (equity and debt) required to generate the profit. A number that is high, and above the return available from a building society, may indicate a successful company that turns out to be a good investment.
* Price to earnings ratio- share price divided by historic or prospective earnings per share. A stock’s price to earnings (P/E) ratio will be judged in relation to the ratios of other companies in the same type of business.
* Dividend yield, dividend per share divided by share price. This shows the return that the annual dividend per share represents in relation to the current share price. The higher the yield, the more attractively valued the stock, assuming that the dividend payment is sustainable
* Price to book ratio - share price divided by net book value (shareholders’ equity) per share. This compares the current share price with the company’s break-up value.

1. **What is the key difference between a Lifestyle Fund and a Target Date Fund?**

**5 marks**

Relevant section of the manual is Part 4 Chapter 1.3.

Format: short paragraph

Answer should cover:

* Both funds aim to de-risk over time
* Lifestyling – investment in growth assets gradually switched to defensive funds from 5-10 years before retirement
* Target date – investment remains in the same target date fund until retirement, but asset allocation is automatically adjusted over time rather than varied through different combinations of growth and defensive funds

1. **Outline the main objectives of the Pensions Regulator and the powers it has to act where it believes an employer is deliberately attempting to avoid its pension obligations.**

**10 marks**

Relevant section of the manual is Part 5 Chapter 1.3.

Format: list (objectives) and bullets with short explanation (powers)

Answer should cover:

* Governing legislation The Occupational Pensions Regulatory Authority (OPRA) was established by the Pensions Act 1995 and was replaced by TPR from 6 April 2005 under the terms of the Pensions Act 2004
* The 5 objectives set out in the legislation• to protect the benefits of members • to promote, and to improve understanding of the good administration of work-based schemes • to reduce the risk of situations arising which may lead to compensation being payable from the PPF • to maximise employer compliance in relation to the automatic enrolment requirements • to minimise any adverse impact on the sustainable growth of an employer (in relation to the exercise of TPR’s functions under Part 3 of the Pensions Act 2004 (scheme funding) only
* Powers – explain contribution notices, financial support directions and restoration orders

1. **Explain what a swap is and briefly describe 5 types of swap.**

**15 marks**

Relevant section of the manual is Part 2 Chapter 4.1 and Part 3 Chapter 2.4.

Format: paragraphs or bullets a short explanation for each

Answer should cover:

* Features of a swap - Swaps are contractual agreements where two parties agree to exchange (swap) either single payments or a series of payments in the future. While some swaps are highly complex, most contracts involve the swap of a fixed payment for a floating series of payments. Swap contracts can be tailor made to each investor’s specific requirements. They are not traded on an exchange, but OTC, like forwards. Financial organisations, such as banks and other money market institutions, are the main operators in the swaps market.
* Types:
  + Interest rate swap
  + Inflation swap
  + Index swap
  + Currency swaps
  + Credit default swaps

1. **Write short notes on how risk can be reduced by improving the employer covenant.**

**5 marks**

Relevant section of the manual is Part 3 Chapter 1.1.

Format: note form/bulleted

Answer should cover:

* Charge on assets
* Parent company guarantee
* Escrow account

1. **A major reason for funding pension schemes in advance is to provide security for members.**

**Explain how this security is achieved.**

**5 marks**

Relevant section of the manual is Part 1 Chapter 1.1.2.

Format: descriptive

Answer should cover:

* Meeting cost of benefits promised
* Why a trust is important
* How the size of the fund affects the level of security

1. **Write a Report to explain to a newly appointed trustee the workings of an Absolute Return Fund with particular reference to**

* **Absolute Return versus Relative Return**
* **How Absolute Return Funds aims to achieve their objective**
* **Multi-asset or asset allocation approach**
* **Long/short funds**
* **Equity market-neutral fund**

**35 marks**

Relevant section of the manual is Part 2 Chapter 4.2.

Format – Report

Answer should cover

* Introduction explaining that the fund generated consistent, positive returns regardless of whether the underlying markets were rising or falling.
* Absolute Return versus Relative Return – former aims to achieve a defined target on an annual basis. The latter’s objective is to outperform a benchmark index.
* How Absolute Return Funds aims to achieve their objective – flexibility, greater risks, reduction in costs.
* Multi-asset or asset allocation approach- invest in a broad range of assets plus across a number of regions with unconstrained investment strategies.
* Long/short funds – incorporate disfavoured stocks into an investment strategy as a means of generating profits or hedging risk.
* Equity market-neutral fund - relatively low risk.