INSTITUTE AND FACULTY OF ACTUARIES

EXAMINERS' REPORT

April 2021

Subject CP3 – Communications Practice
Core Practices

Introduction

The Examiners' Report is written by the Chief Examiner with the aim of helping candidates, both those who are sitting the examination for the first time and using past papers as a revision aid and also those who have previously failed the subject.

The Examiners are charged by Council with examining the published syllabus. The Examiners have access to the Core Reading, which is designed to interpret the syllabus, and will generally base questions around it but are not required to examine the content of Core Reading specifically or exclusively.

For numerical questions the Examiners' preferred approach to the solution is reproduced in this report; other valid approaches are given appropriate credit. For essay-style questions, particularly the open-ended questions in the later subjects, the report may contain more points than the Examiners will expect from a solution that scores full marks.

The report is written based on the legislative and regulatory context pertaining to the date that the examination was set. Candidates should take into account the possibility that circumstances may have changed if using these reports for revision.

Paul Nicholas
Chair of the Board of Examiners
July 2021

© Institute and Faculty of Actuaries

A. General comments on the *aims of this subject and how it is marked*

Subject CP3 consists of two parts as follows:

Written communication

1. Produce a written piece of communication that explains a scenario typically faced by an actuary in their day-to-day work. This communication will be aimed at a non-actuary, although the target audience's level of financial knowledge and understanding will vary from question to question.

2. The communication needs to be of a standard that would be acceptable as a first draft. It is important that the recipient would both understand the communication and be satisfied with the response. The marking schedules include details of the marks awarded including the necessary content. To the extent that it makes the communication unclear or confusing for the audience.

Reflective questions

1. These are a set of questions designed to allow candidates to consider the approach that they took in their communication and justify certain decisions. For example, candidates may be asked what information they felt was relevant for this audience, or which terms they specifically excluded because they would constitute jargon.

2. Candidates are provided with some background reading a few days before the exam (the Scenario Material) to allow them to familiarise themselves with the scenario without being under exam conditions. Candidates are expected to read the information provided, but are not required to do any further reading or research around the scenario.

B. Comments on *candidate performance in this session of the examination*

1. Candidates were asked to produce a paper for a trustee board of a pension scheme outlining the challenge posed on the fee-charging structure by the recent increase in small pension pots. The trustees are responsible for the trust, and will therefore understand how the pension scheme works and will already have a grasp of its key risks. They do not need a detailed explanation of their role, or of basic concepts such as the difference between active and deferred members. Specific areas of detail that are need to understand this scenario, such as the current charging structure, should be explained.

A good answer included:

1. An outline of the changes in the proportion of small pension pots in recent years, and a brief explanation of the drivers of this change.
2. The impact of the current charging structure on members who have small pension pots.
3. The impact that the increase in small pension pots has on the Scheme, and its ability to fund its expenses.
4. Mention of other charging structures that are in common use, and a recommendation that the current charging structure is reviewed.

 © Institute and Faculty of Actuaries

5. It was common for candidates who scored poorly to include far too much unnecessary information. Often these candidates explained very basic concepts to the trustees, such as explaining what they were responsible for, or giving detailed descriptions of an active or deferred member. This is an informed audience who have a responsibility for the performance of the Scheme, and so it is reasonable to assume knowledge of these basic points. Candidates should consider what information the trustee board would need in order to understand and contextualise the information on charging structures that is being presented, and not deviate from this.

6. Some candidates also included a lot of information on the alternative charging structures. Given that the aim of the paper was to recommend that a full review of charging structures takes place it is sufficient to highlight that other charging structures are used, and give a brief outline of these. Candidates have been asked to comment on the advantages and disadvantages of different charging structures, but there is no need to provide a full analysis of the impact of each one on the Scheme.

7. There were a number of issues with visual aids in the answers to this paper. Where candidates scored poorly, they tended to over complicate the visual aid, by showing too much information on one chart (e.g. including a second y-axis), or by showing splits of information that did not aid the trustees understanding of this particular issue (e.g. showing a full distribution of the sizes of pension pots in the scheme).

8. For question two, a number of candidates relied on generic answers, and did not tailor these to the specific scenario in the question. To gain full marks on question two, the answer should be grounded in the scenario, and in particular consider the specific audience that the paper has been written for.

C. Pass Mark

The pass mark for this exam was 59.
1,267 presented themselves and 720 passed.

 © Institute and Faculty of Actuaries

Sample Answer for Subject CP3 – April 2021

Q1
To: Trustees of OTA Master Trust
From: Kit Taylor
Date: 15 April 2021

Small Pension Pots at OTA Master Trust

This paper has prepared by Kit Taylor and is addressed to the Trustees of OTA Master Trust ('the Trust'). The purpose of this paper is to provide details on small pension pots and answer questions raised by the Trustees.

This paper will cover:

- The background behind the increasing number of small pension pots.
- The problems associated with small pension pots.
- The impact of the Trust's charges on small pension pots.

Background to small pension pots

The term 'small pension pot' is assumed to mean a deferred pension savings account with a value of less than £1,000. An active pension pot may have a value of less than £1,000 but would not be considered to be a small pension pot. This is because contributions will continue to be paid, and the value of the pot will grow. A 'small pension pot' is one which has a low value, and which no longer receives contributions.

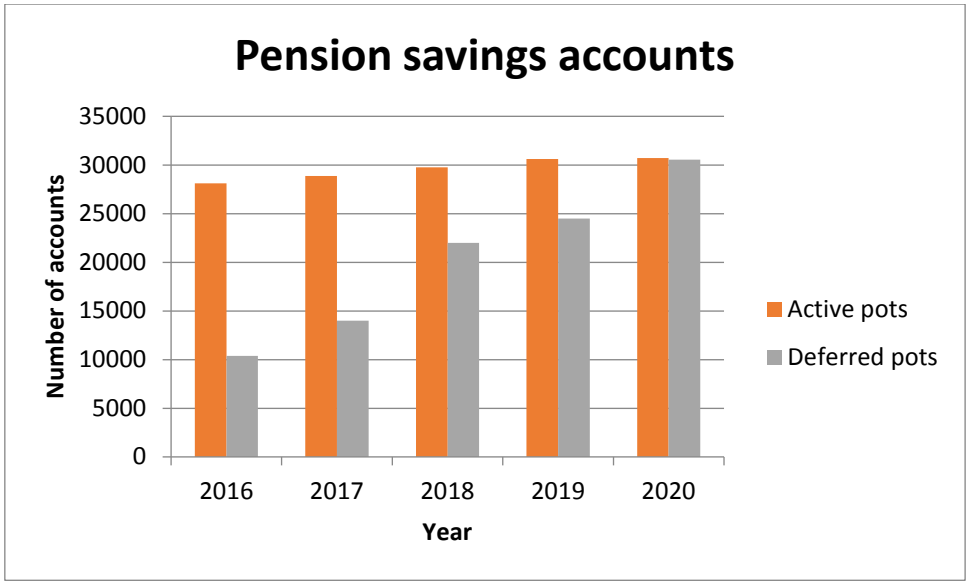
Over recent years the number of small pension pots across all pension providers has been increasing. There are two reasons behind this rise; the introduction of auto-enrolment, and an increase in deferred members.

The introduction of auto-enrolment has led to a large increase in the number of employees enrolled in workplace pension schemes. While historically only higher-paid employees had pension pots, now all employees are eligible. This has led to an influx of members who are earning a lower salary and therefore making relatively small pension contributions. Alongside the increasing number of members, pension schemes are also seeing a rise in deferred members. Lower-paid employees, whose numbers have increased due to auto-enrolment, are more likely to move jobs. The deferred pots they leave behind are often small, because they haven't been in force for long, and the contributions were relatively small. The current economic uncertainty may also lead to greater unemployment. This could further contribute to the rise in deferred members.

Increase in small pension pots at OTA Master Trust

The Trust has seen significant increases in the number of small pension pots. The graph below shows the number of pension pots held in the Trust, for each of the last five years, split by active and deferred. This shows that while the number of active pots has increased slightly since 2016, the number of deferred pots has increased at a much faster rate. At the end of 2020, almost half of the Trust's pots were deferred. If the trend continues, deferred pots will soon outnumber active pots.

 © Institute and Faculty of Actuaries



The graph above shows the increase in deferred pots of all sizes. At the end of 2020 the proportion of all the Trust's pots which would be classed as a 'small pension pot' was 42%.

Issues with small pension pots

Small pension pots can be problematic for both scheme members and the Trust. A member may feel that the pot is too small to contribute to their retirement, and there is a risk of the pot being forgotten, particularly if it relates to a short time with an employer. Where the charges include a fixed charge, these fixed charges will have a more significant impact on small pots and could even reduce them to zero. This is considered in more detail in the next section. This could lead to unhappy members with no funds available for retirement.

Monthly charges are taken from each pot to cover the Trust's costs. Depending on the charging structure, the charges levied on small pots may not cover the Trust's costs. There is a risk that this jeopardises the financial stability of the Trust.

Impact of charges on small pension pots

The current charging structure (deducted from pots on a monthly basis) for the Trust is:

- £16 annual flat-fee, and;
- 0.25% annual management charge (AMC),

For small pension pots this charging structure could erode the value of pot to zero before retirement. The table below gives an example of what the value of the pot would be at retirement (age 68) for a deferred member aged 22.

Value at age 22	Value at retirement
£100	£0
£500	£200
£1,000	£1,500

This shows that for small pension pots, the charges levied can outstrip any fund growth and result in a decreased fund value, or even no value, at retirement.

 © Institute and Faculty of Actuaries

The current charging structure was chosen to ensure that the Trust's expenses are covered. The expenses for the Trust are administrative costs which are a flat fee per member, and investment costs which vary by pot size. Therefore, setting the charges to be a mix of a flat fee and a set percentage of the pot size aims to reflect the actual expenses of the scheme. The percentage charge means that larger pots will incur higher charges. This reflects the high investment costs associated with these pots.

The flat fee charge is the same for all members. It is this part of the charges that results in the value of small pension pots being eroded, because it will be a relatively significant percentage of the small pots.

We have considered alternative charging structures used by other Master Trusts. The advantages and disadvantages associated with these structures are indicated below:

- Percentage charge only - this would be unlikely to erode pots to zero but the Trust wouldn't cover its administrative costs on small pots. This would result in larger pots having to subsidise small pots.
- Flat fee only – this would ensure administrative costs were covered on pots of all sizes. It is likely to increase the problem of eroding the value of small pension pots, as a higher flat fee would be needed to cover all expenses, and the investment expenses on large pots might not be covered.

Given the challenges that small pension pots present, we recommend that the board considers performing a charging review. While the review in 2017 showed that the charging structure would be sufficient until 2027, this was based on the assumption that deferred pots would account for 40% of all pots in the scheme. Given that currently almost 50% of pots are deferred and we expect to see that proportion increasing, the assumption used in the review does not now hold.

<u>Summary</u>
A small pension pot is a pot belonging to deferred member where the value is less than £1,000. The number of small pension pots is expected to increase. Small pension pots can pose a problem for both the member and the Trust. The trustees may want to review the current charging structure given the increasing number of small pension pots to ensure that costs are covered and the charging is fair to members.

If you would like any more information on the subject please do contact me on XXX-XXXXXX.
Kit Taylor

Q2
(i)
The trustees have varying backgrounds but should all have some knowledge of pension schemes. For that reason I used words such as member, deferred and active.
I kept the language simple and clear, for example giving the definition of a small pension pot.

 © Institute and Faculty of Actuaries

I avoided including too many figures due to the varying backgrounds of the trustees. Instead I used graphs and tables to present the figures that I believed helped with the explanations. Similarly, I avoided providing too much detail that might not be easily understood, for example the details of the pension charges review.

(ii)
I excluded details from pension charges review. In particular I did not list all the assumptions used in the modelling. This level of detail was not appropriate for the paper which only provided a high level discussion on the current charging structure. I also excluded the details on the administrative cost and levy as these figures may be out of date as the review was conducted in 2017.
I decided to exclude the modelling data for policies deferred at age 40. I felt that it was unnecessary because:

- It did not illustrate a point that was not already illustrated by including the data for deferred pots at age 22
- Reducing the information being presented helped to keep the paper concise and easier to digest by the Trustees.

(iii)
I chose to use a bar chart to display the number of active and deferred pots. I wanted to show the trend of increasing deferred pots over time and the bar chart shows this clearly.
I used a table to display the effect of charges on the policy deferred at age 22. The table allows the trustees to easily and clearly see the impact on the pension pot for different starting pot values. While I could have used a chart to display this data I felt that the table was more appropriate for the size of the data set, and made it easier to compare.

END OF SAMPLE ANSWER

 © Institute and Faculty of Actuaries

Solutions for Subject CP3 - April 2021

Q1
FORMAT
(i)
Paper Format
Clearly addressed to the Trustees (in header or first line of paper) [1]
Suitable title for paper – mentions small pension pots [1]
Date [½]
Author (acceptable for author to come at end of document) [½]

(ii)
Grouping of ideas
Document is grouped into an appropriate number of sections (excluding introduction and summary). Award 2 marks if 3–6 sections, 1 mark if 2 or 7 sections, otherwise 0 marks. [2]

(iii)
Logical order of points
Logical order between sections. When awarding marks here, consider the overall heading and purpose of the section rather than the content within it.
If read once and clear then 2 marks, if needed to re-read parts then 1 mark, otherwise 0 marks. [2]
Logical order of points within each section. When awarding marks here consider the order of points within each section. If read once and clear then 3 marks, if one section needed to be re-read then 2–1 marks, otherwise 0 marks. [3]
Points within each section are directly relevant to the heading. [1]
Appropriate short headings on each section [2]
Give a mark to each appropriate heading up to 2 marks in total. Long headings or headings that don't succinctly describe what follows don't get a mark.
Sentences kept brief [2]

Award 2 marks if there are no overly long sentences. Award 1 mark if there is one overly long sentence. If more than one overly long sentence, award 0 marks. The principle is that a sentence containing more than one message or too many sub-clauses is too long, or, if spoken, needs repeated breaks to articulate.

(iv)
Format of visual aids
Clear presentation of the historic data on the number of active and deferred pots. [2]
For the best visual aid:

- The correct chart type has been chosen to best show the information (e.g. bar chart for annual changes, pie chart for snapshot of proportions etc.) [1]
- The split of data chosen for the chart is appropriate (e.g. data has been grouped to ensure message to trustees is clear) [1]
- The chart is easy to read, with a title and clear labels on axes [1]

[Total 20]

 © Institute and Faculty of Actuaries

LANGUAGE

(v)

Overall Language

Language used is simple and will be easily understood by the trustees. Award:
5 marks if the document is understandable as a whole
4–3 marks if up to two points need to be redrafted
2–1 marks if three to four points or one section needs to be redrafted
0 marks if more than four points or more than one section needs to be redrafted [5]
Professional tone (avoid comments which "talk down" to the trustees). [1]
Avoid colloquialisms, informal and/or emotive language. [1]

(vi)

Jargon terminology & relevancy

Absence of technical terms. Award 4 marks if there are no terms present which are too technical for the recipient. Award 2 marks if there is one unexplained technical term. If there are two or more unexplained technical terms, award 0 marks. A list of jargon terms is supplied below which will include unnecessary technical terms where a simpler term exists, terms and/or abbreviations which may be acceptable but are unexplained. [4]

Superfluous accuracy of numbers (such as too many decimal places) is avoided. Award 3 marks if all numbers quoted use an appropriate level of accuracy. Award 2–1 marks if up to two numbers quoted in the text or up to six numbers in a table have been quoted with excessive accuracy. If more numbers have been quoted with excessive accuracy award 0 marks. [3]

Absence of irrelevant points of content. Award 5 marks if no irrelevancies, award 3 marks if one irrelevant point, 1 mark if two irrelevant points. If more than two irrelevant points award 0 marks. [5]

Examples or irrelevant points include:
Concepts that are explained that are very basic for the trustees:

- What the trustee's role is
- The different types of members within the scheme – active vs deferred
- What happens to a pension pot when someone leaves employment

Covering points that are not relevant to the message of the paper

- What happens to a pension pot when the member retires

Too much detail on the concepts introduced in the paper

- Very detailed explanation of the charging structure
- Giving all examples provided in the scenario material (ages, pot size etc.)

(vii)

Grammar, spelling and punctuation

Award 3 marks if no significant grammatical, spelling or punctuation errors, 2 marks if one error, 1 mark if two errors. Award 0 marks if more than two errors. Each "error" should be significant enough to compromise the professionalism of the document or require sections to be redrafted. [3]

[Total 22]

 © Institute and Faculty of Actuaries

CONTENT

(viii)

Introduction

State that the paper will address questions about small pension pots [1]

Signpost that the paper will discuss:

Why the number of small pension pots is increasing [1]

Why small pension pots are a problem [1]

The impact of the Trust's charging structure [1]

(ix)

Increase in the number of small pension pots

Explanation that small pension pot refers to pots less than £1000 [1]

Clear that it is deferred pots that are the issue, as active pots are expected to grow with contributions [1]

Two reasons for increasing number of small pension pots

- Auto-enrolment [1]
- Increase in deferred members [1]

Auto-enrolment has meant many new pension scheme members who are lower paid [1]

Lower paid employees are more likely to move jobs frequently [2]

Leaving behind a small pension pot [1]

Potential future economic uncertainty / increased unemployment will increase the number of deferred pots further [1]

Like other pension providers OTA has seen an increase in small pension pots [1]

Number of active pots has increased slowly but number of deferred pots has increased much faster [2]

At end of 2020

- Almost half of Trust's pots were deferred pots [1]
- 42% of Trust's pots were small pension pots (or 84% of deferred pots were 'small') [1]

(x)

Problems with small pension pots

Small pension pots are a problem for members [1]

and the Trust [1]

Members likely to forget about small pension pots [1]

Members more likely to feel that small pension pot won't contribute to retirement [1]

Charges can erode pot value to zero [1]

Trust's financial position at risk if the Trust's costs aren't covered by charges, which is more likely for small pension pots [2]

(xi)

Current charging structure and impact on pots

Current charging structure is mix of flat-fee and percentage charge [1]

This aims to cover the actual expenses of the Trust [1]

 © Institute and Faculty of Actuaries

For small pots, fund growth could be less than charges so value eroded over time [1]
Show an example where charges erode value [2]
Alternative of percentage charge only unlikely to cover costs on small pots [1]
Alternative of flat fee only unlikely to cover investment expenses for larger pots [1]
Recommend that the charging structure is reviewed [1]
Because the last review in assumed 40% of pots would be deferred [1]
But currently around 50% are deferred / we expect the proportion to continue increasing [1]

(xii)
<u>Summary</u>
Small pension pots - deferred pension pots with values less than £1000 potentially pose a challenge for the trustees [1]
Number of small pension pots in the Trust is increasing [1]
Small pension pots can be a problem for the member and the Trust [1]
Recommend that the charging structure is reviewed [1]
Include a sign-off with contact details should the reader have further questions [1]
[Total 40]

(xiii)
<u>The trustees will be completely satisfied with the response and the responder has made a good impression.</u>
The communicated answer is clear and easy to read, the response flows through to a conclusion. It looks good, it is well set out, and it has the right tone of voice. It satisfactorily and completely answers the question. The responder has made a good impression on the trustees. [6–8 mark]

<u>The trustees are left with some question marks over the responder, and therefore over aspects of the answer given.</u>
The trustees have been given an answer that is partially understandable although the response does not quite flow freely through to a conclusion. Some information in the argument is obviously missing and/or there are one or two visual mistakes and anomalies in the look of the response. Some technical terms may have been used that are not entirely clear. The committee are left with some question marks over the responder, and perhaps therefore over aspects of the answer given. [3–5 mark]

<u>The trustees are left with a poor impression of the responder, are confused by the answer and/or do not trust the answer.</u>
The answer will leave the trustees confused. The communication is poorly written or possibly too technical. There are some obvious mistakes in the arguments, tables or charts do not make sense and/or are not properly labelled. The answer does not flow, but rather jumps around. The layout is not consistent throughout the communication. There may be spelling mistakes or the trustees have not been properly addressed. The tone of voice is wrong, perhaps too informal. The trustees have been left with a poor impression of the responder and therefore do not trust the answer. [0–2 mark]
[Maximum 8]
[Total 90]

 © Institute and Faculty of Actuaries

Q2

Reflection Question / Marks

(i)

- Language should be simple, e.g. I defined AMC as 'annual management charge' when first using it – it is possible that the trustees would understand this, but defining it reminds them and makes the document easier to read.
- I avoided using too many figures – I just picked out the most relevant projections so that the trustees were not overwhelmed by figures. They have differing backgrounds and therefore it is likely they will not all appreciate having a lot of figures to digest, and the main message can be conveyed with just a few.
- Gave examples to illustrate points, for example I quoted a few projections for a 22 year old to show how the pot value could be lower, or even zero, at retirement for small pots.
- Displaying figures in an appropriate manner – I included the projections of future fund values in a simple table rather than including the figures within the text. [4]

Award one mark for each valid point with a relevant example
½ mark can be awarded for valid point with no example

(b)

- Assumptions from the pension charges review – level of detail not needed
- Expenses stated in the pension charges review – may be out of date
- Modelling data for the alternative charge structures – too much detail
- Size data for active pots – not needed to answer the trustees' questions
- Details of how an annuity is calculated – not relevant to the paper
- Details on how the scheme works – trustees' will already understand the scheme

[4]

1 mark for piece of information and
1 mark for reason, Max 4

(c)

- Chart to show the number of deferred pots over time. Shows the increasing trend clearly.
- Table to show value of pots at retirement under current charging structure. Used so easy to compare and see the actual figures. [2]

[Total 10]

Jargon

Always jargon	**Maybe jargon**	**Not jargon**
Any equations	AMC	Active
Modelling	Escalating / non-escalating	Deferred
Brokerage	Gilts	Pension pot
Proportionality	Fixed / variable charges	Scheme
Simulations	Apportioned	Investments / investment returns
Investment linked		Member
		Contribution

 © Institute and Faculty of Actuaries

		Fund
		Auto-enrolment
		Transfer
		Annual management charge

[Paper Total 100]

END OF EXAMINERS' REPORT

© Institute and Faculty of Actuaries