INSTITUTE AND FACULTY OF ACTUARIES

EXAMINERS' REPORT

September 2020 Examinations

Subject SP4 – Pensions and Other Benefits Specialist Principles

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

Mike Hammer
Chair of the Board of Examiners
December 2020

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

1. The aim of the Pensions and Other Benefits Specialist Principles subject is to instill in successful candidates the ability to apply, in simple situations, the mathematical and economic techniques and the principles of actuarial planning and control needed for the operation on sound financial lines of providers of pensions or other employee benefits.

2. This subject examines the ability of candidates to apply core actuarial techniques and concepts, together with specific knowledge of pensions and other benefit arrangements to simple, but practical situations.

3. The Examiners therefore look for candidates to apply their knowledge of the Core Reading to the specific situation that the Examiners asked, having read the question carefully. Many candidates write around the subject matter of the question in more general fashion, or focus on one aspect of the issue at great length, in either case gaining few of the marks available.

4. Good candidates demonstrate that they have used their time well - an attempt to get a logical flow is a big advantage in making points clearly and without repetition. This also enables candidates to use the latter parts of questions to generate ideas for answers to the early parts (or use their solutions to earlier parts of questions to create a structure for latter parts). Time management is important so that candidates give answers to all questions that are roughly proportionate to the number of marks available. Candidates who give well-reasoned points, not in the marking schedule, are awarded marks for doing so.

B. Comments on *candidates' performance in this diet of the examination*

This was a well-balanced exam paper and the better prepared candidates passed.

It is very important that candidates consider all aspects of the question, and read the preamble fully. By using all of the information available, candidates can ensure they give a full answer. Giving just a little more to clearly show depth can turn a close fail into a pass. The questions are set so that it should take approximately twice as long to answer a 10 mark question as a 5 mark one. Answers should therefore be similarly proportionate.

The questions that were least well answered in this paper were questions Q4iii, examining design of a DC scheme, Q5ii and Q5iii examining monitoring experience and Q6ii examining investment risks. These were all application and higher order skills questions and candidates generally lacked the depth of response required to score highly in these questions.

Candidates are reminded to pay attention to the command verbs and practice these types of questions as part of their preparation. A list of what is expected for each command verb is available on the IFoA website.

C. Pass Mark

The Pass Mark for this exam was 63.
226 candidates presented themselves and 81 passed.

Solutions

Q1

(i)

Company insolvency	[½]
A new scheme is set up for future accrual	[½]
The company no longer wishes to finance the scheme	[½]
Cost - the company can no longer afford to finance the scheme	[½]
The company wishes to crystallise a surplus built up in the scheme	[½]
Risk - the company wishes to remove future uncertainties from its balance sheet	[½]
Drain on management time due to increased regulatory burden and governance	[½]
Merger with another scheme	[½]
A regulator may require the scheme to discontinue e.g. on security grounds (or for other valid reason)	[½]
The trustees may discontinue the scheme if they feel this best protects accrued rights	[½]

[Total marks available, Max 2]

(ii)

Costs

The company should consider the relative cost of the two options	[½]
Together with the level of available assets	[½]
And any other additional resources that could be contributed into the scheme to makeup any shortfall in costs	[½]
An insurance company will value the liabilities very prudently	[½]
The insurer will have to cover all of their statutory reserving requirements	[½]
And will also include in the premium a margin for profits and expenses	[½]
Plus the transaction is a one-off and so the insurer can never ask for more money in the future, so will include a contingency margin	[½]
The company may consider the expenses of implementing each option	[½]
Including the ongoing expense of administering the scheme if it continues	[½]
If the scheme continues, the company may need to pay additional contributions if a deficit arises in the future	[½]
Although there may be flexibility in timing to pay these contributions compared to the immediate cost of insurance	[½]
Insurance premiums may decrease/increase over time	[½]
For example due to supply/demand issues in the market	[½]
The company may consider temporarily running as a closed scheme only until insurance becomes affordable	[½]
The scheme may include benefits that are expensive to insure	[½]
Such as high fixed pension increases	[½]
And benefits may be reduced to make the transaction affordable	[½]

The company may consider the opportunity cost of the transaction / what alternative projects it could invest in [½]

The company could consider partially insuring the benefits [½]
For example a buy-in of pensioner liabilities only [½]

Risks
An insurer would take on the risks for all future experience [½]
For example investment, mortality or inflation. [½]

If the scheme continued, the company would need to manage the ongoing risks [½]
But it would also benefit from any positive future experience [½]

The company may consider advocating a "self-sufficiency" approach [½]
Such that the scheme has a good chance of meeting liabilities without further contributions [½]
Under such an approach there is likely to be increased prudence in the funding basis [½]
And/or a lower risk investment strategy [½]
Such as a government bonds / LDI [½]
So that the assets are closely matched to the liabilities [½]
But this is likely to reduce the current funding level [½]
There may be a liquidity risk if the company needs to contribute additional funds To secure a transaction [½]
Or a risk that assets need to be realised at an inopportune time to raise the capital [½]
If the scheme continued there may be a risk of built up surplus becoming trapped in the scheme that the company can no longer access [½]

Other / General
The company should consider the impact on their accounting disclosures [½]
The company may consider any limitations or requirements from legislation or the scheme rules [½]
The company may consider the expectations of the members [½]
Including the award of discretionary benefits, which may not be included in the insurance terms [½]
And any options in the scheme – which may be unavailable or on different terms with an insurer [½]
And the relative strength of the insurer covenant vs the company [½]

The company may consider the views of the Trustees [½]
For example how the funding/investment strategy may change if the scheme was run as a closed scheme [½]

There may not be an insurer willing to take on the liabilities of the scheme [½]

[Total marks available 22, maximum 10]

(iii)
The cost of purchasing insurance is more than providing a transfer value [½]
This is because insurers will use a very prudent basis to determine the premium [½]
This is particularly the case for deferred members [½]
As there are significant uncertainties over a long-term period of time [½]
For example longevity improvements [½]

While a transfer value is unlikely to have any allowance for prudence [½]
As they are usually calculated on a best estimate basis [½]
Therefore the overall cost of discharging the liabilities is expected to decrease [½]
The cost saving will depend on the level of enhancement provided [½]
Which should be high enough to encourage members to take up the option [½]
But not so high as to increase the value above the cost of purchasing insurance [½]
The cost saving will depend on the take-up of the option… [½]
… And the profile of those taking up the option [½]
For example members in ill/health or single may select against the scheme [½]
Any saving will be offset by the cost of running the exercise [½]

[Total marks available 7 ½, maximum 4]

(iv)
Advantages
The member benefits from the enhancement over a normal transfer value / gets increased value [½]
Gives flexibility in terms of how benefit is taken [½]
So member can tailor retirement options to suit their needs [½]
For example take all or part of their benefit as cash or keep fund invested and drawdown over time [½]
Or purchase an annuity with different options [½]
Such as different increases [½]
Or no spouse pension [½]
Which may be advantageous to a single person who could then use the entire fund value to meet their own needs [½]

Or they may be able to structure benefits in a more tax efficient way [½]
If member is in ill health they may be able to pass on a greater proportion of their fund to a dependant / use the fund to purchase an enhanced annuity [½]

The transfer may lead to improved security if the employer is at risk of insolvency[½]

Disadvantages
By taking a transfer value, member is giving up a guaranteed pension for life… [½]
…And instead member must bear ongoing risks [½]
Including investment, mortality and inflation risks [½]
And so they may end up with a worse outcome [½]
If using the fund to purchase an annuity of the same form as the scheme benefits, it is unlikely they will be able to secure benefits as valuable as they are giving up [½]

As the enhanced transfer value is set to be lower than the cost to insure the benefit [½]

[Total marks available 8½, maximum 5]

(v)

Ensure communications to members are clear and unbiased [½]
For example by providing information on both the value of the lump sum and the benefit sacrificed [or other relevant example of how advice could be clear/unbiased] [½]
The communications could be reviewed by an independent third party / Trustees [½]
Could also provide additional information / roadshows / forums for members to raise questions [½]
So that they can make informed decisions [½]
Require members to take financial advice [½]
Which could be paid for by the company [½]
No non-pension incentives (such as cash) should be used to influence member choices [½]
Members should be given sufficient time to come to a decision [½]
And the option may be guaranteed over this timeframe [½]
Vulnerable members may be excluded from the exercise [½]
Or included on an opt-in basis only [½]
Compliance with any relevant guidance and best practice [½]

[Total marks available 6 ½, maximum 3]

[Total 24 marks]

This question was generally well answered with many candidates scoring well.

Q2

(i)

Central discontinuance fund to secure member benefits in the event of sponsor insolvency [½]
Require advance funding of benefits [½]
Require a minimum level of funding [½]
Require separation of scheme assets from sponsor's other assets [½]
Under independent control e.g. by Trustees [½]
Require protection of benefits for those who leave/withdraw before retirement age [½]
Regular checks on the adequacy of funds earmarked to provide benefits [½]
And requirement to put in place a deficit reduction plan if there are insufficient funds [½]
[½]
Restrictions on the types of investments allowed [½]
For example investment in the scheme sponsor [½]
Or charges on investment funds [½]

Regular disclosure to beneficiaries of the adequacy of funds and the ways in which the funds are managed [½]
Requirement to appoint professional advisers such as actuaries and lawyers [½]
With ethical and professional standards for all professional advisers [½]
For example minimum training levels / qualifications / CPD [½]
And authorisation of individuals/organisations that manage or invest any funds [½]
External regulator to monitor benefit provision [½]
Require individuals who are involved in or advise on the administration / funding /investment to report bad practice to the regulator [½]
Require regular monitoring of sponsor covenant [½]
Restrictions on corporate activity e.g. dividend payments / cashflows that would weaken covenant [½]

Regulate to place unfunded benefit obligations as a high priority debt in the event of insolvency [½]
Require financial guarantees / contingent assets (from parent company or shareholders) [½]
Requirement to hold insurance against inadequacy of funds in the event of insolvency, negligence, fraud or any other appropriate event [½]
Requirement for letters of credit to be provided for schemes from banks [½]
Requirement for minimum credit ratings for organisations whose finances may affect the availability of funds [½]

[Total marks available 13, maximum 6]

(ii)

The CDF would need to find a practical and cost-effective approach … [½]
and is therefore likely to consider only publically available information [½]

Financial metrics from sponsor accounts [½]
e.g. statistics on balance sheet / profitability / cashflows / … [½]

Credit rating [½]
Implied market default risk from issued investments [½]
Merton type model [½]
[Max 2 marks for examples]

[Total marks available 3 ½, maximum 3]

(iii)
The CDF may not provide full scheme benefits so the benefits valued may not be representative [½]
For example only provides statutory minimum benefits / leaving service benefits / no discretionary benefits / … [½]
The assumptions used may vary by scheme [½]
And the funding method may vary by scheme [½]
And may reflect specific contingent assets / guarantees that underpin the funding [½]
This would make a consistent comparison across schemes more difficult [½]
The latest valuation may not be very recent and therefore not representative of current risk [½]
Or would require the CDF to carry out extra work to bring the results more up to date [½]
May leave the levy open to manipulation [½]
For example if deliberately weak assumptions are chosen to show a low deficit to reduce the levy [½]
Which would also jeopardise the security of member benefits [½]
Unlikely to be representative of the cost to the CDF of providing benefits [½]
For example the underlying investment strategy of the CDF is likely to be more prudent [½]
[Total marks available 7 ½, maximum 3]

[Total marks 12]

This question was generally well answered with many candidates scoring well.

For part (ii), many candidates failed to recognise the practicalities that a CDF would need to consider, and suggested solutions that we not readily available and scalable, for example independent business reviews. Candidates are reminded to consider the specifics given in the question and tailor their answer appropriately.

Q3

(i)
Under the Projected Unit Method, the Actuarial Liability is the discounted value of benefits that have accrued in the past period of membership of the beneficiaries. [½]
In determining this value, allowance is made for any future expected inflationary growth of the ongoing benefit up to retirement age. [½]

The Standard Contribution Rate is that necessary to maintain the fund at the target Actuarial Liability over the control period / cover the cost of all benefits which will accrue in the control period. (1)

[Total marks available 2]

(ii)
A lower discount rate is used instead

The Actuarial Liability would be higher [½]
And the Standard Contribution Rate would be higher [½]
As the discounted value of all future cashflows (relating to past and future accrual) will be higher [½]
And the greater the reduction in discount rate the greater the impact [½]

[Total marks available 2, maximum 1½]

A control period of one year is used instead

There would be no change to the Actuarial Liability [½]
As the value of past benefits does not depend on the control period [½]
The Standard Contribution Rate would decrease (for i>e) [½]
As the cost of accrual increases with age (for i>e) [½]
And a shorter averaging period leads to less aging [½]

The cost of accrual increases over time [½]
Because the average age of the membership increases over time [½]

[Total marks available 3½, maximum 2]

The Current Unit Method is used instead

The Actuarial Liability will be lower for active members [½]
Assuming that earnings growth is higher than leaver revaluation [½]
But the same for non-active members assuming the same approach to revaluation is adopted [½]
The Projected Unit Method Actuarial Liability allows for projected earnings growth over the period from date of calculation to retirement age [½]
Whereas the Current Unit Method may only allow for any statutory minimum revaluation that applies to leaver benefits for active members [½]
Or no revaluation [½]

The accrual term of the CUSCR will be lower than the PUSCR [½]
However the term to allow for salary increases (possibly in excess of leaver revaluation) over the control period on the CUAL is likely to be significant [½]
As the scheme is mature [½]
So overall the Standard Contribution Rate will be higher [½]

[Total marks available 5, maximum 3½]

The scheme is closed to future accrual

There is no change to past benefits if a salary link is retained [½]
Therefore there would be no change in Actuarial Liability [½]
Otherwise the Actuarial Liability will decrease [½]
Assuming earnings growth is higher than leaver revaluation [½]

The Standard Contribution Rate would be zero [½]
As there is no future accrual [½]

[Total marks available 3, maximum 2]

[Total marks 11]

This question was generally well answered.

For part (ii), the conversion to the Current Unit Method was where some candidates didn't score so well.

It was surprising to see that many candidates did not understand that the SCR is zero in a scheme with no future accrual. Very few candidates commented that there would be no change to past benefits if a salary link is retained.

Q4

(i)
A flexible benefit scheme is a form of benefit provision where the beneficiary has choice about
The types of benefits [½]
And the level of benefits [½]

It will usually involve an option to receive salary instead of other forms of benefits [½]
It allows individuals to select the benefits that best meet their needs [½]
For example … risk benefits / childcare vouchers / … [½]
And therefore they should appreciate the benefits more [½]
Individual needs may be different for different parts of the workforce… [½]
… Or may change over time as personal circumstances change [½]
For example … e.g. getting married / having children / … [½]
The employer can change the benefits offered at little or no cost [½]
Any exchange terms for switching between benefits will provide a value so employees can understand / appreciate their value better [½]

[Total marks available 5½, maximum 3]

(ii)
Contributions
Members could choose the amount they wish to contribute [½]
The employer may match employee contributions [½]
The member may be able to transfer in funds from another arrangement [½]

Investment
Members can select which funds to invest in [½]
And the amount of investment risk they wish to take [½]

Benefits
Members could choose the age at which benefits are taken [½]
And may take different benefits at multiple different ages [½]
Members can have options on how to receive their benefit at retirement.
For example: [½]
Take it as a cash lump sum [½]
Purchase an annuity from an insurer / within the scheme … [½]
… where the level of pension increases secured … ½]
… or the level of dependant benefits secured are determined by the member [½]
Income drawdown [½]
And may choose to receive benefits in multiple ways [½]

Member may vary the level of protection benefits [½]

[Total marks available 8, maximum 6]

(iii)
Contributions
Members may pay insufficient contributions to provide adequate provision [½]
Which could lead to reputational issues for the company. [½]

There may be regulatory restrictions… [½]
…For example limits on what level of contributions qualify for tax relief [½]
…Or minimum requirements to ensure adequacy of retirement savings [½]

If contribution matching, the company is exposed to the risk that members increase their contributions… [½]
…So may introduce a employer contribution beyond which no matching occurs [½]

Investment
Members may make unsuitable investment choices [½]
Because they may not understand the risks [½]

There is a risk the member will have insufficient funds on retirement to meet their needs [½]
For example investing in funds which are overly prudent and therefore limit investment growth [½]
Or funds that do not appropriately match the benefits that will be taken at retirement [½]
Or risky assets that default [½]

Therefore the choice of investments may be limited [½]
Or financial advice / guidance provided for members [½]
Although this would increase the costs of providing the benefit [½]
A default fund may be required for members that do not engage with the investment flexibilities [½]
This may include a life-styling element [½]
To reduce the volatility of retirement outcomes [½]

Benefits
Members can tailor the level and form of benefits to best meet individual needs [½]
For example if the member is married or not or takes into account their health [½]
There is a risk that members will make inappropriate benefit choices [½]
For example drawdown at too high a level so they run out of funds before death [½]

General
Additional flexibilities increase administrative complexity (and therefore cost) [½]
And may make communication more difficult [½]
Could increase employee engagement as they can better tailor benefits to their needs [½]
But could decrease engagement if the number of decisions to make becomes overwhelming [½]

[Total marks available 13½, maximum 8]

[Total marks 17]

Candidates generally scored well in parts (i) and (ii).

For part (ii) some candidates failed to generate sufficient points which, in turn, meant they were unable to score well in part (iii). Although, in general, candidates struggled to generate sufficient points for part (iii). Better scoring candidates considered the implications from several view points.

Q5

(i)

Transfer value	[½]
Trivial commutation	[½]
Early retirement	[½]
Late retirement	[½]
Exchange pension for additional increases	[½]
Exchange pension increases for additional non increasing pension	[½]
Exchange pension for additional spouse protection	[½]
Additional Voluntary Contributions	[½]
Bridging pension / elect to receive a higher initial pension which steps down at a future time	[½]

[Total marks available 4½, maximum 3]

(ii)

The actuary will consider the appropriate period over which to analyse experience	[½]
Data will be required for each member that retired over the period	[½]
Including the total pension at retirement	[½]
And the amount of pension taken as cash	[½]
Removing those who received their whole pension as cash due to triviality or serious ill health.	[½]
The actuary will consider the need to group any data	[½]
For example to consider the experience by size of pension / exclude trivial commutation	[½]
Or exclude serious ill health commutation	[½]
Or any other relevant grouping	[½]
All pensions should be revalued to a consistent date to ensure a fair comparison	[½]
The average proportion of pension taken as cash, in each homogenous group, is then equal to The total (revalued) pension taken as cash summed across the group divided by the total (revalued) pension at retirement summed across the same population	[1]
The actual (average) proportion of the pension commuted is equal to the average proportion of pension taken as cash divided by 25%	[½]
Alternatively a crude measure could be used e.g. taking an average of the percentage commuted for each individual member	[½]
Although this crude analysis does not take into account the size of the pension	[½]

[Total marks available 7½, maximum 5]

(iii)

The results of any analysis should not be used blindly	[½]
Consideration should be given to whether the period under investigation was typical	[½]
For example there may have been a change in legislation or abnormal event in the investigation period which encourages / discourages take up of the option	[½]
Or a change in the factors to make them more/less generous	[½]

Or the results may be skewed by the option of one member with a significant pension [½]
Or there may be significant random fluctuations or errors in data [½]

There may be a gradual change in experience over the period [½]
And care should be taken to identify whether past trends are likely to continue in the future [½]

Consideration should be given to the quality of the data [½]
For example whether there is sufficient data for the analysis to be credible [½]
A large scheme is likely to have enough data to perform credible analysis [½]
But this may not be the case at all ages [½]
Whether the data is recent enough to be relevant [½]
Consideration should be given to whether experience is homogeneous across all groups or whether further grouping of data is appropriate [½]
For example if the 15% taking no cash are correlated [½]
e.g. in time / pension size [½]
The actuary may recommend reducing the assumption to reflect experience [½]

The basis used to set commutation factors is often less prudent than the funding basis so that if members do take cash, there is an experience gain. [½]
Therefore the current assumption is not prudent based on experience [½]
There may be additional elements of prudence elsewhere in the basis [½]
And the materiality of changing the assumption may mean any changes are not significant… [½]
for example if there is little difference in the assumptions used for funding and setting commutation terms [½]

[Total marks available 11, maximum 6]

(iv)
Advantages
Scheme managers are concerned with the security of benefits and so could prevent members taking commutation if this would jeopardise the security of the fund [½]
For example if the value of the cash taken is higher than the value of the benefits surrendered [½]
Such as if commutation terms are fixed and the market related valuation basis would be weaker than the basis used to set the factors [½]
Or to prevent members selecting against the scheme e.g. if they are in ill health [½]
May aid in liquidity planning [½]

Scheme managers are independent of company so would not be influenced by company concerns in approving/disapproving commutation requests [½]

Disadvantages
May reduce take-up rate of the option [½]
Which may reduce security of remaining benefits as risk remains in the scheme rather than being reduced [½]

This is likely to cause an increase costs. For example: [½]
Will add administrative complexities [½]
And may require legal advice / amendment of the scheme rules [½]

It will also occupy significant trustee time given the size of the scheme [½]

Role is also to ensure fairness between all members [½]
Therefore it would not be appropriate to treat individuals differently on a case by case basis [½]
There is precedent in the scheme for members taking cash [½]
So it may be difficult to withhold consent in practice [½]
And may lead to complaints / disgruntled members [½]

[Total marks available 8½, maximum 5]

[Total marks 19]

Part (i) was well answered, with most candidates scoring full marks. A number of candidates stated cash commutation as an option for part (i), when the question asked for other options to cash commutation.

Candidates struggled to score well in part (ii). Many candidates failed to understand that it is the proportion of the amount of pension commuted that is important, rather than the proportion of members who commute.

Part (iii) was also not well answered with many candidates not picking up the broader points around the use of results of a model, including points around prudence and materiality.

Part (iv) was generally answered a little better, but many candidates did not make broad enough points to score well. Few candidates commented on the advantages and disadvantages of needing consent from the sponsoring employer, rather than the scheme managers.

Q6

(i)
Terminal funding is an arrangement whereby a payment to meet the present value of a benefit is made only at or about the time when the benefit is due to commence. [1]

Security of member benefits [½]
As funds are not set aside until the point where benefits are in payment [½]
So if the sponsoring company was to go insolvent there would be less funds available to meet the benefit promises [½]
Stability of company contributions [½]
Contributions are not smoothed over time and therefore depend on when members retire [½]
This is not within the company's control [½]
Liquidity risk [½]
As the contribution is paid in a single lump sum rather than smoothed over time [½]
If a funding plan involves low contributions now and high contributions later the employer may gain an unrealistically low impression of pension cost in the short term. [½]
Flexibility [½]
No flexibility in terms of timing of contribution as required to pay when benefits fall due [½]

If experience is not as assumed then there may be need for additional contributions in the future [1]

[Total marks available 7½, maximum 6]

(ii)
Assets held
Asset values may be volatile [½]
This can be positive as more volatile assets like equities usually have a higher expected return [½]
Generally a pension scheme is a long-term investor and so short-term volatility should not cause concern [½]
Although if the funding regime requires valuations at set intervals, this may be more significant [½]
This may be a particular concern if the sponsor covenant is weak [½]

Default risk [½]
For example default on a bond repayment [½]
Or insolvency of a company leading to loss of all share value [½]

Currency risk from any overseas investments [½]
The scheme is well diversified across a range of asset classes [½]
Which should reduce the concentration of the risks above [½]
The scheme should also ensure there is diversification within each asset class [½]
To limit the exposure to any one counterparty [½]

There is a risk that returns are lower than expected [½]
Which would increase the cost of providing the benefits [½]
And could ultimately jeopardise the security of the benefits [½]

Reinvestment risk e.g. from coupon payments on bonds [½]

(Total marks available 9, maximum 4)

Payment of benefits
As a general principle it is the risk relative to the liabilities that is important rather than the absolute risk [½]
For example the scheme is mature [½]
Therefore the scheme may invest in assets with a shorter term [½]
For example the liabilities are inflation linked [½]
Therefore the scheme may invest in index-linked rather than fixed bonds [½]
The scheme can limit these risks by adopting a matching strategy [½]
Although this may not be possible if there is a deficit in the scheme [½]
And it would reduce the chance of any future surplus arising so benefit improvements would be unlikely [½]

There is liquidity risk in relation to benefit payments [½]
To ensure there is sufficient cash to pay benefits as they fall due [½]
This can be mitigated by holding assets that produce an income [½]
For example bonds [½]
Or holding assets that can readily be sold [½]
This may be higher if the scheme provides risk benefits [½]
Although this could be mitigated by insurance [½]

[Total marks available 7½, maximum 4]

Governance of the funds
Misappropriation of assets / fraud [½]
For example by custodian or a key stakeholder [½]

Mismanagement of the scheme by the custodian [½]
... including failure to manage conflicts of interest if they are also the investment adviser [½]
Inappropriate advice from professional advisers leading to an ineffective strategy [½]

[Total marks available 2½, maximum 1½]

General
Changes in legislation [½]
For example the taxation regime for investments [½]

High expenses [½]
For example management charges / expenses of professional manager [½]
Or transaction costs if buying/selling assets [½]
Environmental / social / governance risks that may affect the value of assets held [½]

[Total marks available 3, maximum 1½]

[Total marks maximum 17]

[Paper Total 100]

Part (i) was generally well answered.

For part (ii) many candidates didn't write sufficient detail to score well. Those candidates that split their answer into the headings provided in the question were able to score better than those that didn't.

END OF EXAMINERS' REPORT