Examiners' Report - Core Unit 4 – Financing and Investing for Retirement Provision

Question 1

Describe the 4 most common valuation techniques used to value shares. (10 marks)

Study Manual Reference: Section 2, Chapter 1.4

Reason for Asking the Question: This question assessed candidates' understanding of the main methods used to value shares, a fundamental skill for making informed investment decisions. The ability to correctly describe and compare these methods is vital for understanding how share valuations are determined in practice.

Where Candidates Passed or Failed:

Passed:
- Clearly described all four methods: Discounted Cash Flow (DCF), Price-to-Earnings (P/E) Ratio, Net Asset Value (NAV), and Comparable Company Analysis (CCA).
- Demonstrated when and how each technique is applied, with practical examples.
- Explained key assumptions, such as cash flow projections in DCF or industry comparisons in CCA.

Failed:
- Omitted one or more valuation techniques or provided incorrect definitions.
- Focused disproportionately on one method, e.g., DCF, without adequately addressing the others.
- Lacked precision or practical examples to support their explanations.

Question 2

Explain what is meant by pooled and segregated investment approaches and list the main differences between them. (5 marks)

Study Manual Reference: Section 6, Chapter 1.2

Reason for Asking the Question: This question tested candidates' ability to differentiate between pooled and segregated approaches, critical for understanding the structure and management of pension fund investments.

Where Candidates Passed or Failed :

Passed:
- Accurately defined pooled and segregated investment approaches.
- Highlighted differences such as cost-efficiency (pooled) versus customisation (segregated).
- Discussed implications for ownership, governance, and fees.

Failed:
- Provided vague or incomplete definitions.
- Confused the two approaches or failed to mention critical differences.
- Did not address how these approaches affect scheme operations.

Question 3

Describe a buy-in and a buy-out, explaining the key features of each. (20 marks)

Study Manual Reference: Section 2, Chapter 2.7

Reason for Asking the Question: This question assessed candidates' understanding of two key risk management strategies for Defined Benefit (DB) schemes. Knowledge of buy-ins and buy-outs is essential for trustees managing scheme liabilities.

Where Candidates Passed or Failed:

Passed:

- Clearly defined buy-ins (liabilities remain with the scheme) and buy-outs (liabilities transferred to insurer).
- Explained how each strategy affects scheme governance and funding.
- Provided relevant examples of application.

Failed:

- Did not distinguish clearly between buy-ins and buy-outs.
- Omitted key points about liability ownership or financial implications.
- Lacked examples or detail on practical considerations.

Question 4

Outline the three broad categories of investment funds used in DC arrangements. (7 marks)

Study Manual Reference: Section 4, Chapter 1.2

Reason for Asking the Question: This question tested candidates' understanding of investment fund categories and their relevance to Defined Contribution (DC) pension schemes, emphasising risk-return profiles and member choice.

Where Candidates Passed or Failed:

Passed:

- Correctly identified growth, defensive, and balanced funds.
- Explained their purpose and associated risk profiles.
- Provided examples of asset allocations within each category.

Failed:

- Misclassified funds or omitted one or more categories.
- Failed to describe the risk-return characteristics adequately.
- Provided vague or overly simplistic answers.

Question 5

Describe the ways in which trustees may invest in infrastructure. (12 marks)

Study Manual Reference: Section 2, Chapter 3.6

Reason for Asking the Question: This question evaluated candidates' understanding of infrastructure investments, which offer pension schemes diversification and long-term inflation-linked returns.

Where Candidates Passed or Failed:

Passed:

- Described multiple approaches, such as direct investments, pooled funds, debt financing, and public-private partnerships (PPPs).

- Discussed the benefits (e.g., diversification, inflation hedging) and challenges (e.g., illiquidity).
- Provided examples of infrastructure projects, such as renewable energy.

Failed:

- Focused narrowly on one method without mentioning others.
- Lacked discussion of risks, such as liquidity constraints or regulatory considerations.
- Did not provide examples or context.

Question 6

Explain the principles of day-to-day cash management of a trustee bank account. (5 marks)

Study Manual Reference: Section 5, Chapter 2.1

Reason for Asking the Question: This question assessed candidates' knowledge of operational cash management, an essential skill for trustees to ensure compliance and financial oversight.

Where Candidates Passed or Failed:

Passed:

- Explained key principles such as liquidity management, transaction reconciliation, and monitoring cash flows.
- Highlighted the importance of separating trustee and employer funds.
- Discussed the role of third-party administrators and trustee oversight responsibilities.

Failed:

- Provided incomplete answers, omitting key principles like liquidity management.
- Failed to address trustee accountability when delegating to third parties.
- Lacked examples or detail.

Question 7

List the types of pension arrangements which do not require an auditor. (6 marks)

Study Manual Reference: Section 5, Chapter 2.3

Reason for Asking the Question: This question tested candidates' knowledge of governance requirements and audit exemptions, fundamental for managing pension schemes.

Where Candidates Passed or Failed:

Passed:

- Correctly listed exempt arrangements, such as Small Self-Administered Schemes (SSASs) and Executive Pension Plans (EPPs).
- Explained why certain arrangements do not require audits.

Failed:

- Provided incorrect or incomplete lists of exempt arrangements.
- Did not explain the criteria for exemption.

Question 8

Describe the factors affecting bond values. (15 marks)

Study Manual Reference: Section 2, Chapter 2.1

Reason for Asking the Question: This question evaluated candidates' understanding of fixed-income securities and the key drivers of bond valuation.

Where Candidates Passed or Failed:

Passed:

- Identified factors such as interest rates, credit risk, inflation, and duration.
- Explained the inverse relationship between interest rates and bond prices.
- Provided practical examples of how external factors, like economic conditions, impact bond values.

Failed:

- Omitted significant factors or provided superficial explanations.
- Confused key concepts such as yield and duration.
- Lacked examples or context.

Question 9

Outline the general factors which should be taken into account by trustees when selecting an investment manager. (20 marks)

Study Manual Reference: Section 6, Chapter 2.1

Reason for Asking the Question: This question tested candidates' understanding of best practices in selecting investment managers, emphasising governance, performance, and alignment with scheme objectives.

Where Candidates Passed or Failed:

Passed:

- Discussed key factors such as track record, investment philosophy, fees, and alignment with scheme goals.
- Emphasised due diligence, transparency, and ESG considerations.
- Provided examples of criteria for manager selection.

Failed:

- Focused too narrowly on performance without addressing governance.
- Lacked detail on transparency or investment mandates.
- Did not include practical examples.