Actuarial Society of South Africa

EXAMINATION

21 October 2013

Subject A302 — Communications

EXAMINERS' REPORT

General Examiner's comments

Question 1

This question tested candidates' ability to understand and convert a technical issue into material that could be understood by a Chairman of the Trustees possessing little technical background.

Candidates needed to address each category of staff individually and further split administrative staff by duration until retirement. Some candidates failed to differentiate administrative staff by duration, whilst others erred in their calculations.

Question 2

This question tested candidates' ability to redraft a fairly technical, and sometimes confusing, original document. All the information required in the Fact Sheet was given in the question. Candidates needed to discern what information to convey within a limited word count. Jargon needed to be kept to a minimum as the Fact Sheet needed to be understood by a secretary.

An introductory paragraph was necessary to frame the topic and may have been used to alert the reader to the fact that a summary table would be given at the end of the Fact sheet.

Many candidates failed to explain how coupon payments are calculated for Inflation Linked FSBs.

Question 1

E-mail Marking Schedule

Length: Full marks can be given if range falls within **450 – 550.**

Format: Sender's and recipient's contact names and e-mail addresses, as well as Cc (copy features) and the subject line are left justified. Addresses contain correct punctuation e.g. e-mail addresses are underlined. Day, date and time of message are added automatically but are usually on the right so students can indicate this <day/date/time>. They may also indicate attachments.

Language: This section includes choice of words, register/level of language, avoidance of jargon and overly numeric approach, style & tone, grammar, punctuation, spelling etc.

Planning and structure: This involves the use of headings from the subject line to headings in actual e-mail. Also includes the logical, coherent arrangement of information, good sentence and paragraph structure, good clear use of information without technical formulae etc. as well as good beginning, middle, end conventions: Opening paragraph: goodwill and topic identification; relevant body explanations and close: goodwill once again and pointing the way ahead.

Content and objectives

1. Taxation

- Different employee categories, different tax rates
- Contributions
    - into Fund from after tax money (saying "taxed" is acceptable)
    - into RA tax free, up to 5% of pensionable salary / 15% non-pensionable salary

2. Administration fees

- None on additional member contributions to Fund (*summary statement)*
- Deducted on RA investments
- T Woodward's research paper or paper name "Impact of admin fees on retirement saving"
- Impact of admin fees highest on members close to retirement/ with lowest expected duration (*summary statement)*

3. Impact by employee category

- Lecturers
    - 40% tax deduction on contributions into Fund, none if into RA
        - or correctly calculated Rand amount pm or pa
    - Admin fee 30% wrt RA, none if into Fund
        - or correctly calculated Rand amount pm or pa
    - Better for additional contributions into RA/save if in RA/similar

- Administrators
  - 25% tax deduction on contributions into Fund , none if into RA (or similar to lecturers)/tax covered in summary above
  - Admin fee into RA age/duration dependant
    - From age 20, less than 18%
    - From 45, 30%
  - Better for additional contributions into
    - RA if young/long duration, Fund if older/short duration/similar
    - Exact age/duration of change unknown

- Support staff
  - no tax
  - better for additional contributions into Fund/not into RA

4. Summary of who benefits when

- Depends on age/duration and employee category/tax rate

The communication meets the recipient's objectives and presents the communicator in a credible fashion.

- Chairman understands why lecturers better off in RA
- Chairman understands difference between young and older administrators
- Chairman understands why support staff better off in Fund
- Suggest communication to members, decision left to trustees

E-mail Draft Solution

From: Nellie Jet <Nellie@RGT.ac.za>
To: Koos van Rooyen < KvR@RGT.ac.za>
Subject: AVCs now allowed under the RGT Retirement Fund
Attachment: TWood.doc

Good morning Koos

Thank you for the informative email about AVCs that I recently received. It all looks helpful, but from my actuarial background, I do have one concern that I thought I would pass on to you in case you want to act on it. My concern is that the e-mail may be viewed by some members as trustee encouragement to invest any additional retirement money into the RGT Retirement Fund. For some members, this will be financially advantageous. However, other members would be better off investing additional retirement funds into a retirement annuity (RA).

A member’s employee category and age determine whether or not he would be better investing additional funds in the RGT Retirement Fund or an RA.

Taxation
Different employee categories are taxed at different rates. Additional contributions by members into the Fund will be made from after tax income. Contributions into an RA of up to 5% of a member’s pensionable salary can be made tax free. This amounts to 15% of the 25% of income on which retirement contributions are not based.

Administration fees
Administration fees will not be charged on any additional member contributions into the Fund from 1 January 2014. Administration fees are deducted every year while money remains invested in an RA pre-retirement.

I have attached a peer-reviewed paper by T Wood sets out the impact of administration fees on regular retirement savings. Essentially, the impact of administration fees is highest on members closest to retirement.

Impact by employee category
Both taxation and administration fees reduce the ultimate retirement benefit of members. I explain the combined impact on each employee category below.

Lecturers
Any contribution by lecturers to the Fund would take place after a tax deduction of 40%. If additional retirement money was channelled into a RA, no tax would be paid. However, administration fees amounting to 30% or less of their RA contribution would be charged. It is better for lecturers to make additional retirement contributions into a RA. Receiving a tax saving of 40% outweighs the associated administration cost of 30%.

Administrators
Administrators are taxed in a similar way to lecturers. However, their tax rate is lower at 25%. The cost impact of RA administration fees will depend on the age at which the

member starts making additional contributions. A member contributing additionally from age 20 would experience an administration related cost of less than 18%. The comparable figure for a lecturer contributing from age 45 is 30%.

Older administrators would be better off investing additional contributions into the Fund. The cost associated with a RA contribution is greater than the tax saving made on such an investment. The opposite is true for younger administrators. The research paper doesn't make it clear from what age payments should be made into a RA.

Support staff
Support staff do not pay tax. Their retirement benefit reduces if administration fees are charged. It is better for them to make additional contributions into the Fund than into a RA.

Conclusion
It is financially advantageous for some administrators and all lecturers to invest additional money into a RA rather than into the Fund. I suggest that this is communicated to members. Administrators could be advised to seek individual advice before deciding where to invest any additional retirement money.

Regards
Nellie Jet
[approximately 540 words]

<u>Question 2</u>

Fact Sheet Marking Schedule

Length: Full marks can be given if range falls within **450 – 550.**

Format: This is the content of a fact sheet which will be used for informing unsophisticated investors (a lay audience). Marks are available for appropriate use of paragraphing, and creating a design that would be appealing in terms of font (type and size) bold for headings etc. (the *extrinsic* aspects of structure and layout). i.e. what does the fact sheet actually look like?

Language and tone: This section includes choice of words, register/level of language, avoidance of jargon, style and tone etc. It is important that the fact sheet is written in an accessible tone to appeal to the audience (potential investors). The language use should be jargon free and yet explain clearly and simply what the concepts are. The tone should be a careful balance between purpose to inform (as well as to express some personal rapport with investor (courteous, reassuring, expert). Technical details must be clearly explained so that the product is understood by the potential investor. This is ultimately a fact sheet, not a sales pitch. An appropriate tone would be one that explains the product features clearly, in a way that highlights/compares the features of the two types of RSBs to the client. Using terms such as 'you' in the factsheet is appropriate so that the reader feels that (s)he is being addressed personally. However, a professional approach is still required, which is not familiar or colloquial as readers still strangers and this is a professional exchange.

Planning and structure: The opening should be interesting enough for reader to continue. The facts must be set out in a logical and coherent arrangement. How the fact sheet progresses through the different concepts must aid the explanation of the product as a whole. The comparative table is important and must be clear. Internal arrangements of fact: description/definition, explanation, comparison and contrast. The explanation must not jump around too much in a manner that will cause confusion. The table must be clearly embedded (lead-in) and add value to the fact sheet. This section is more about the *intrinsic* aspects of structure.

Overall impression: How does the fact sheet 'hang' together in terms of unity, coherence and emphasis, logical development, and overall structure of message? Do all the elements above work together to create a good understanding of the product? Would the reader be able to make sense of it and would this type of document allow for more informed decisions?

Content and objectives

The following points **should** be included:

1. Two types of RSBs: Fixed Interest and Index Linked (explicitly as intro)

2. General to both RSB types

- Secure as guaranteed by government (or low risk/quite safe also acceptable from technical viewpoint; *statement will be negatively factored into communication mark*)
- Similar to granting loan to government of fixed term
    - Capital/loan repaid at end of period
        - Cash/paid out or reinvested at same rate as new investment *(acceptable wherever stated, including in table)*
    - Interest biannually
- No associated expenses

3. Fixed Interest FSB

- 2, 3 or 5 years term *(acceptable wherever stated, including in table)*]
- Interest payments
    - based on return of similar government bonds[1]
    - differ depending on length of investment
    - received cash/paid out or reinvested at initial investment rate
    - interest rate fixed once investment made

4. Inflation linked FSB

- 3, 5 or 10 years term *(acceptable wherever stated, including in table)*
    - Capital repayment linked to CPI/inflation

- Interest payments
    - Calculation similar to Fixed Interest RSB, except linked to inflation linked bonds
    - Base/initial interest rate determined on date of purchase
    - Actual payment = base increased with inflation since purchase
    - Received cash/paid out

5. Accessing the investment early

- Possible, a year after initial investment
- Repayment within 20 business days of request receipt
- Financial penalty = last interest payment

6. Separate nature of investment growth and income in table

7. Bonus if explain difference between inflation linked and fixed

The following **should not** be included: **deduct** marks for

- Facts not mentioned in government website excerpts
- Expected return numbers/comments

Would you, as a financially curious secretary, understand the content in non-technical terms?

- Who pays what when
- How fixed interest repayments are calculated
- How index-linked repayments are calculated (base level explained; inflation link
- Accessibility of invested capital

Fact Sheet Draft Solution

Fact Sheet: RSA Retail Savings Bonds

Investors often want to understand the differences between different types of investment. RSA Retail Savings Bonds (RSBs) are explained in this Fact Sheet. The explanation covers what types of RSBs are available and how you, the investor, can access your investment. A table at the bottom of the Fact Sheet summarises RSB features and will assist you in comparing various investment types.

Investing in RSBs is similar to granting a loan to the RSA government for a fixed period. RSBs can be seen as secure as they are guaranteed by the government. If necessary, the government can increase taxes to fund repayments.

The government will pay you interest on the loan twice a year and will repay the loan at the end of the period. The government sets interest payments at the time of each investment. Investments incur no expenses. There are two types of RSBs: Fixed Interest and Inflation Linked.

Fixed Interest RSB
You can choose to invest for 2, 3 or 5 years. Your interest payments are based on the return available on similar market-traded government loans. The interest varies depending on the length of the investment.

Investors may receive their interest payments or loan repayment amount in cash or reinvest them. Interest reinvestments happen at the same interest rate as the initial investment and are repaid on the same date. Interest granted on loan repayment reinvestments is determined as for a new investment.

Inflation Linked RSB
You can choose to invest for 3, 5 or 10 years. Interest payments and the loan repayment are linked to consumer price inflation.

A base interest payment is determined on the date of purchase. This is calculated in a similar way to interest payable on Fixed Interest FSBs. The only difference is that the reference point is inflation linked government loans. Interest payments are calculated by increasing this base payment with inflation experienced since the date of investment. They increase as inflation increases. Investors receive their interest payments in cash.

The loan repayment amount is the initial loan amount plus an amount to compensate you for inflation over the investment period. Investors can receive this in cash or reinvest it. Reinvestments are treated as new investments.

Accessing the investment
The loan amount is normally repaid to you at the end of the term of the investment. It can be repaid earlier on your request provided that a year has passed since the original investment. Repayment will take place within 20 business days of the Government receiving such a request. You will incur a financial penalty if you require early repayment. Your last interest payment will be taken off the repayment amount.

Summary of investment features

Characteristic	Investment	
	Fixed Interest RSB	**Inflation Linked RSB**
Default risk[1]	None	None
Nature of income	Fixed amount	Inflation linked
Nature of investment growth (other than income)	None	Inflation linked
Term	2, 3 or 5 years	3, 5 or 10 years
Early Access	Available with interest penalty	Available with interest penalty
Charges or fees	None	None

1. Risk of losing all invested capital

[approximately 510 words]

END OF EXAMINERS' REPORT

