



ACTUARY PROGRAM ASSIGNMENT COVER SHEET

**THIS FORM MUST BE AT THE FRONT OF EACH ASSIGNMENT
CANDIDATES MUST KEEP A COPY OF THEIR ASSIGNMENT**

Candidate to complete the following section (and update details in header and footer):

Member ID: Sample	COURSE: Asset Liability Management
DATE DUE: Monday 13 March 2023 at 9.00pm (Sydney Time)	

PLAGIARISM

By submitting your assignment, you are implicitly stating that the work is your own.

Remember that an important aspect of being a professional actuary is to always act with integrity.

Committing plagiarism by copying another person's work or not properly referencing other sources used in your assignment is a breach of the Integrity principle under the Actuaries Institute's Code of Conduct.

Be aware that your assignment may be vetted using Turnitin.



Part B Assignment

(Total 10 marks)

Question 1

Consider a country with a democratically elected government, an appointed central bank, an orderly money market, listed exchanges for a wide range of securities across asset classes and an asset management industry facilitating a wide range of investment activities.

Individuals often choose to invest via a diversified investment trust offered by an asset management company, usually after taking advice from a financial advisor who is remunerated by the investment trust.

You have been approached by a friend who is considering such an investment for herself.

Hint "Investment trust" is defined in course materials Module 4 page 20.

Q1 Explain to your friend the roles of these market participants, including how she will benefit **(6 marks)**

- Asset management company;
- Custodian; and
- Credit rating agency.

Answer is

Asset Management Company (AMC):

AMCs provide professional services to a range of investors with differing needs and objectives. As such, they act as an intermediary between capital providers (I.e., retail investors like my friend) and capital seekers (e.g., companies), generally for a fee. They provide the following benefits to my friend:

- Since AMCs provide retail investors with package investment strategies using highly regulated pooled vehicles, my friends capital is essentially being utilised by different investments (e.g., stocks, bonds, real estate). This ultimately provide my friend with diversification benefit, thus expected higher returns in the long term.
- Since AMC's have a larger pool of resources than my friend, they also have access to greater investment options, that would be otherwise unattainable to my friend (e.g., possibly due to minimum requirement). This allows my friend to get proportional returns from such investments.



- AMCs also have investment managers that use their skills and expertise to meet the investment trust's specified objectives. My friend is able to take advantage of this, through the investments selected in the trust, which otherwise be unavailable without AMC.

Custodian

A custodian is a financial institution that holds the securities of its customers (in either electronic or physical form), with the purpose of safekeeping it and minimising risks of theft or loss. They can also serve other roles, such as; distributing security income and keeping owners informed. They are beneficial to my friend because:

- They protect her interests by ensuring the investment trust remains secure and safe
- By doing so, they also provide my friend with confidence in the investment trust and also peace of mind in its security

Credit Rating Agencies (CRA)

Credit rating agencies have the role of evaluating and rating a debtors ability to pay their debt obligations, and hence ultimately provide a credit rating that is useful for investors. As such, they estimate the probability of default in interest or coupon payments, whereby a higher rating indicates a lower likelihood of default by the debtor. They are beneficial to my friend because:

- They provide information that is used by the AMCs to determine the appropriate investment option to meet the trusts objectives, thereby facilitating the trading of securities
- Also provides my friend with an indication of the level of credit risk of the securities in the investment trust, allowing her to understand the credit risk of the various assets in her investment.

Question 2

Explain to your friend three counterparty risks arising for the proposed investment , considering the parties involved. **(3 marks)**

Hint: Only the first three risks discussed will be marked, there is no advantage in a longer list

Answer is

Counterparty risk refers to the risk that the other party may default on their contractual obligations. For the proposed investment, some counterparty risks include:



- **AMC Risk:** There exists a risk that AMC will default on its contractual obligations to meet the investment trust's objectives, as highlighted in the prospectus. As a result, if AMC fails to execute their part of the agreement, my friend can be left with no return of capital.
- **Custodial Risk:** If the custodian does not have appropriate safeguards in place, there is a risk of theft or loss of my friend's investment. This can occur due to the custodian's insolvency, negligence or fraud.
- **CRA Risk:** There is a risk that the CRA provided false, incorrect or misleading information on the creditworthiness of certain debtors. This can result in poor investment performance of the investment fund, whereby compensation was not received for certain credit risks.

See over for Question 3

Question 3

Assess the conflict of interest arising for the investment advisor. **(1 mark)**

Answer is

The conflict of interest occurs due to the remuneration received by the investment advisor by the trust, which can either directly or indirectly interfere with their professional recommendation. Ultimately, the investment advisor must provide advice that is in the best interest of the client (i.e., my friend), however incentives arising due to the remuneration by the investment trust can influence the advice provided causing a conflict of interest.

END OF PART B ASSIGNMENT