



J06

THE CHARTERED INSURANCE INSTITUTE

MONDAY 19 OCTOBER 2009

DIPLOMA IN FINANCIAL PLANNING
J06 – INVESTMENT PRINCIPLES, MARKETS AND ENVIRONMENT

SPECIAL NOTICE

- **All questions in this paper are based on English law and practice applicable in the tax year 2009/2010, unless stated otherwise and should be answered accordingly.**
- **Assume all individuals are domiciled, resident and ordinarily resident in the UK unless stated otherwise.**

INSTRUCTIONS

- **Two hours are allowed for this paper.**
- **Read the instructions overleaf carefully before answering any questions.**
- **Fill in the information requested on the answer book and form B.**
- **If you bring a calculator into the examination room, it must be a silent battery or solar-powered non-programmable calculator. The use of electronic equipment capable of being programmed to hold alphabetic or numerical data and/or formulae is prohibited. You may use a financial or scientific calculator, provided it meets these requirements and you must enter the serial number, model and make on the form B.**
- **You are allowed to write on the inside pages of this question paper but you must **not** write your name, candidate number, PIN or any other identification **anywhere** on this question paper.**
- **The answer book and this question paper **must both be handed in personally by you** to the invigilator before you leave the examination room. **Failure to comply with this regulation will result in your paper not being marked and you may be prevented from entering this examination in the future.****

THE CHARTERED INSURANCE INSTITUTE

J06 – Investment principles, markets and environment

CANDIDATE INSTRUCTIONS

READ THE INSTRUCTIONS BELOW BEFORE ANSWERING ANY QUESTIONS

Two hours are allowed for this paper.

The paper consists of 15 short answer questions and carries a total of 130 marks.

Read carefully the questions and information provided. You are strongly advised to attempt **all** questions to gain maximum possible marks. The number of marks allocated to each question part is given next to the question and you should spend your time in accordance with that allocation.

Any rough notes made in your answer book must be crossed through before you hand it in.

Tax tables are provided at the back of the paper.

Answer each question on a new page and leave six lines blank after each question part.

It is important to show all steps in a calculation, even if you have used a calculator.

Please ensure that you understand the Special Notice printed in the box on the front page.

Subject to providing sufficient detail, you are advised to be as brief and concise as possible, using note format and short sentences on separate lines wherever possible.

Attempt ALL questions

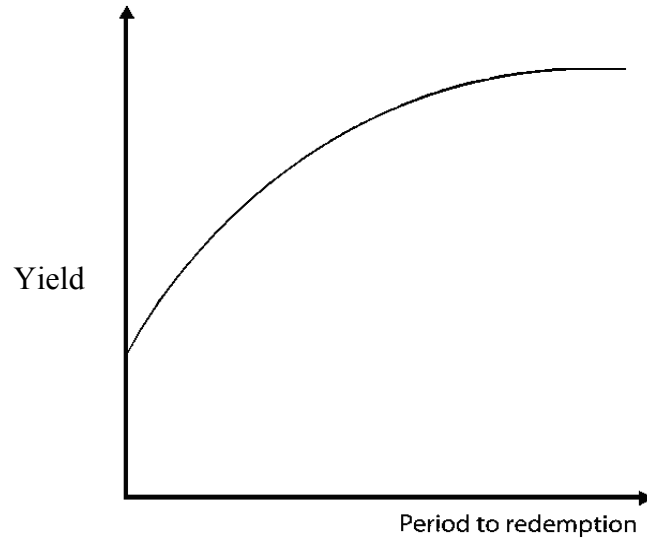
Time: 2 hours

1. (a) Explain why an increase in government spending could be perceived to be a better stimulus for the economy than tax cuts of an equivalent amount. (4)
(b) Explain why a sustained high budget deficit is bad for the economy. (3)
2. Briefly explain **four** essential functions provided by financial systems in a modern economy. (8)
3. (a) Explain briefly what the efficient frontier is. (4)
(b) State **three** potential drawbacks for an adviser of solely relying on the efficient frontier to invest a client's money. (3)
4. A share has a Beta of 0.55. The Risk Free Return is 6% and the Expected Market Return is 9%.
(a) Calculate, **showing all your workings**, the Expected Return on the share. (4)
(b) Explain briefly what the Beta value indicates about this share. (3)
5. (a) Explain briefly the time value of money theory. (2)
(b) Describe the discount factor used in the time value of money calculation. (2)
(c) State **two** factors which influence the discount rate. (2)
6. You have a client who intends to emigrate to Spain to live out his retirement. The client wishes to purchase a portfolio of individual UK corporate bonds to secure his income.

List and describe briefly **six** risks that should be brought to your client's attention in relation to this strategy. (12)
7. (a) List the **four** main areas of measurement that can be analysed from a set of company accounts. (4)
(b) Explain briefly why it is important to look at more than one year's figures when analysing company accounts. (4)

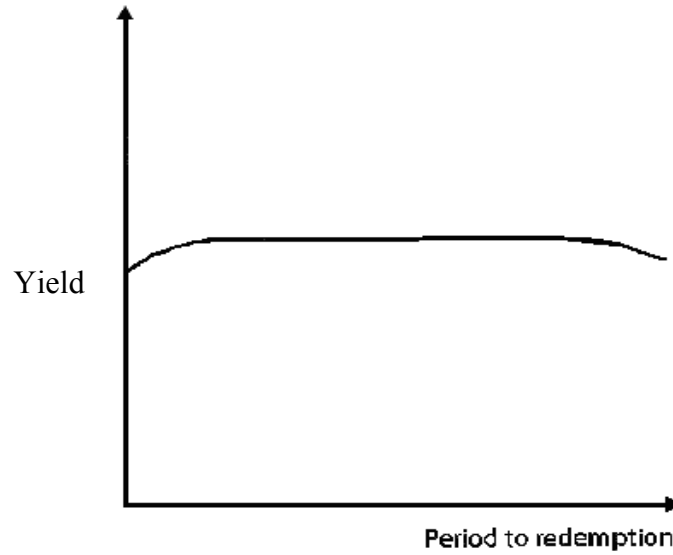
8. Identify the yield curves shown below and describe the circumstances which may cause them.

(a)



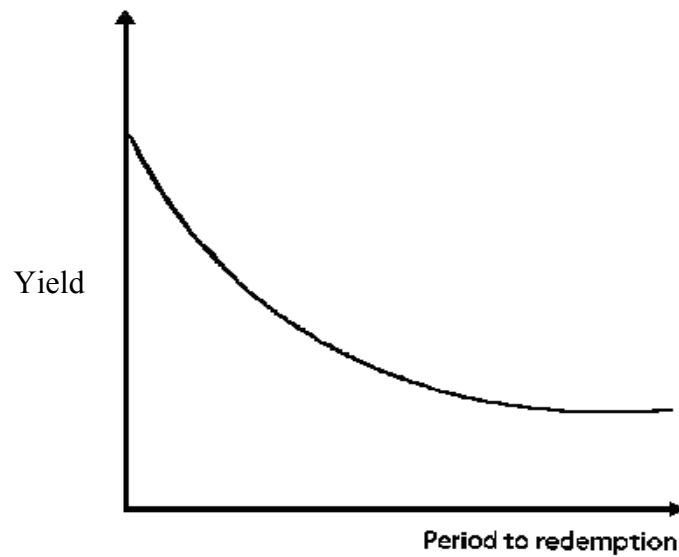
(3)

(b)



(3)

(c)



(2)

9. (a) List **six** reasons why a company may wish to join the Alternative Investment Market (AIM). (6)
- (b) List **three** reasons why AIM investments may not be suitable for an inexperienced investor. (3)
10. A fund manager expects the share price of Oil Plus plc, one of his fund's major constituents, to fall from its current value of £3.00. As a consequence, the manager purchases a Put Option to sell 1,000 shares at an exercise price of £2.40 per share.
- The option premium is 10 pence per share.
- (a) State **four** reasons why the fund manager may have purchased the Put Option rather than simply selling the underlying shares. (4)
- (b) State, giving your reasons, the likely action taken by the fund manager and the consequences for the fund if the share price of Oil Plus plc at expiry is £2.70 per share. (4)
11. (a) State **five** potential benefits of investing in commercial property. (5)
- (b) Explain briefly the potential increased risk of holding commercial property in times of recession. (3)
12. You have completed a fact-find for your client Philip Kyle and having established his constraints and objectives, you are now looking for a suitable investment fund to be included within his portfolio.
- List **seven** main issues that you would consider when selecting a particular fund for a portfolio. *Excluding past performance.* (7)
13. (a) List the **three** components used in calculating:
- (i) the Sharpe ratio; (3)
- (ii) the Information ratio. (3)
- (b) State briefly what the Sharpe ratio and the Information ratio compare. (4)
14. (a) State the main limitations of using the FTSE 100 index for the purposes of benchmarking the performance of a fund manager. (5)
- (b) List and explain briefly the **three** main methods of index tracking. (9)

- 15.** The risk of investing in investment trusts is said to be greater than the risk of investing in unit trusts.

Explain the reasons you would give in support of the above statement.

(11)

TAX TABLES

INCOME TAX RATES

2009/2010		2008/2009	
Rate	Band	Rate	Band
%	£	%	£
10	1 - 2,440*	10	1 - 2,320*
20	1 - 37,400	20	1 - 34,800
40	Over 37,400	40	Over 34,800

* A new 10% starting rate is applied for savings income only from 06.04.2008. Only applicable where non-savings income after allowances is under £2,440 for 2009/2010.

NATIONAL INSURANCE CONTRIBUTIONS

2009/2010 Rates

Class 1 Employee	Weekly	Monthly	Yearly
	£	£	£
Lower Earnings Limit (LEL)	95	412	4,940
Upper Earnings Limit (UEL)	844	3,656	43,875
Upper Accruals Point	770	3,337	40,040

Class 1 Employee contributions 2009/2010

Total earnings £ per week	Contracted-in rate	Contracted-out rate
	%	%
Up to 110.00*	Nil	Nil
110.01 – 770.00	11	9.4
770.01 – 844.00	11	11
Above 844.00	1	1

Class 1 Employer contributions 2009/2010

Total earnings £ per week	Contracted-in rate	Contracted-out rate	
	%	Final salary	Money purchase
	%	%	£
Below 110.00**	Nil	Nil	Nil
110.01 – 770.00	12.8	9.1	11.4
770.01 – 844.00	12.8	12.8	12.8
Excess over 844.00	12.8	12.8	12.8

* This is the primary threshold below which no NI contributions are payable. However, the lower earnings limit is £95 per week. This £95 to £110 band is a zero rate band introduced in order to protect lower earners' rights to contributory State benefits e.g. Basic State Pension.

** Secondary earnings threshold.

Class 2 (self-employed) Flat rate per week £2.40 where earnings exceed £5,075 per annum.

Class 3 (voluntary) Flat rate per week £12.05

Class 4 (self-employed) 8% on profits between £5,715 - £43,875 plus 1% on profits above £43,875

INCOME TAX RELIEFS

	2009/2010	2008/2009
	£	£
Personal (basic)	6,475	6,035
Personal (age 65-74)	9,490	9,030
Personal (aged 75 and over)	9,640	9,180
Married/civil partners (minimum) at 10% †	2,670	2,540
Married/civil partners (age under 75) at 10% †	N/A	6,535
Married/civil partners (age 75 and over) at 10%	6,965	6,625
Age-related relief reduced by 50% of income over	22,900	21,800
Child Tax Credit (CTC)		
family element	545	545
family element baby addition	545	545
CTC usually reduced by 6.67% of joint income over	50,000	50,000
Blind person's allowance	1,890	1,800
Enterprise Investment Scheme relief limit @ 20%	500,000	500,000
Venture Capital Trust relief limit @ 30%	200,000	200,000

† where at least one spouse/civil partner was born before 6 April 1935

PENSIONS

Lifetime Allowance		Annual Allowance	
2006/2007	£1.5 million	2006/2007	£215,000
2007/2008	£1.6 million	2007/2008	£225,000
2008/2009	£1.65 million	2008/2009	£235,000
2009/2010	£1.75 million	2009/2010	£245,000
2010/2011	£1.8 million	2010/2011	£255,000

Notional Earnings Cap

£123,600 – (For schemes that require post 1989 benefits to be still subject to a cap)

Annual allowance charge

40% member's tax charge on the amount of total pension input in excess of the annual allowance.

Lifetime allowance charge

55% of excess over lifetime allowance if taken as a lump sum.

25% of excess over lifetime allowance if taken in the form of income, which is subsequently taxed under PAYE.

INHERITANCE TAX

	2009/2010	2008/2009
Nil-rate band*	£325,000	£312,000
Rate of tax on excess	40%	40%
Lifetime transfers to and from certain trusts	20%	20%
Overseas domiciled spouse/civil partner exemption	£55,000	£55,000

100% relief: businesses, unlisted/AIM companies, certain farmland/building
 50% relief: certain other business assets

Reduced tax charge on gifts within 7 years of death

	0-3	3-4	4-5	5-6	6-7
Years before death					
% of death charge	100	80	60	40	20
Annual exempt gifts	£3,000 per donor			£250 per donee	

* From 8 October 2007 up to 100% of the unused proportion of a deceased spouse's/civil partner's nil-rate band can be claimed on the surviving spouse's/civil partner's death.

MAIN SOCIAL SECURITY BENEFITS

		From 06.04.09	From 06.04.08
		£	£
Child Benefit	first child	20.00	20.00*
	subsequent children	13.20	13.20*
Incapacity Benefit	short-term lower rate**	67.75	63.75
	short-term higher rate**	80.15	75.40
	long-term rate	89.80	84.50
Attendance Allowance	lower rate	47.10	44.85
	higher rate	70.35	67.00
Retirement Pension	single	95.25	90.70
	married	152.30	145.05
Pension Credit	single person standard minimum guarantee	130.00	124.05
	married couple standard minimum guarantee	198.45	189.35
	maximum savings ignored in calculating income	6,000	
	increased from November 2009	10,000	
Bereavement Benefit (lump sum)		2,000.00	2,000.00
Widowed Parent's allowance		95.25	90.70
Jobseekers Allowance		64.30	60.50

* From 5 January 2009

** Under State Pension Age

VALUE ADDED TAX

Standard rate	15%*/17.5%**
Annual registration limit - from 1 May 2009	£68,000

* Effective from 1 December 2008

** Effective from 1 January 2010

CORPORATION TAX

Financial Year	2009 to 31/3/10	2008 to 31/3/09
Full rate	28%	28%
Small companies rate	21%	21%
Small companies limit	£300,000	£300,000
Effective marginal rate	29.75%	29.75%
Upper marginal limit	£1,500,000	£1,500,000

CAPITAL ALLOWANCES

Plant & machinery 100% annual investment allowance (first year)	£50,000
Plant & machinery in excess of annual investment allowance (first year)	40%
Plant & machinery, patent rights, know-how (reducing balance) per annum	20%
Certain long-life assets, integral features of buildings (reducing balance) per annum	10%
Industrial & agricultural buildings (straight line)	2%
Energy & water-efficient investments	100%
Qualifying flat conversions & business premises renovations	100%
Motor cars: with emissions in excess of 160g/km	10%
generally	20%*
with CO2 emissions of 110g/km or less	100%
Research & Development: Capital expenditure	100%
Revenue expenditure - small/medium-size firms	175%
- large firms	130%

* Maximum £3,000

CAPITAL GAINS TAX

Exemptions	2009/2010	2008/2009
Individuals, estates etc	£10,100	£9,600
Trusts generally	£5,050	£4,800
Chattels proceeds (5/3 excess gain is taxable)	£6,000	£6,000
Rates		
Individuals	18%	18%
Trusts and estates	18%	18%

ENTREPRENEURS' RELIEF

Entrepreneurs' Relief 2009/2010

4/9^{ths} of gain tax free. Lifetime limit eligible for relief: £1,000,000

For trading businesses and companies (minimum 5% employee shareholding) held for 1yr+

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