

Chartered  
Insurance  
Institute

# AF4

## Advanced Diploma in Financial Planning

Unit AF4 – Investment Planning

October 2018 Examination Guide

### SPECIAL NOTICES

Candidates entered for the April 2019 examination should study this examination guide carefully in order to prepare themselves for the examination.

Practice in answering the questions is highly desirable and should be considered a critical part of a properly planned programme of examination preparation.

## AF4 – Investment planning

### Contents

Important guidance for candidates .....	3
Examiner comments .....	8
Question paper .....	11
Model answers .....	20
Tax tables .....	28

---

**Published February 2019**

Telephone: 020 8989 8464  
Fax: 020 8530 3052  
Email: [customer.serv@cii.co.uk](mailto:customer.serv@cii.co.uk)

**Copyright © 2019 The Chartered Insurance Institute. All rights reserved.**

## IMPORTANT GUIDANCE FOR CANDIDATES

### Introduction

The purpose of this Examination Guide is to help you understand how examiners assess candidates' knowledge and their ability to apply this to a case study scenario. You can then use this understanding to help you in your preparation for the examination.

### Before the examination

#### Study the syllabus carefully

This is available online at [www.cii.co.uk](http://www.cii.co.uk). All the questions in the examination are based directly on the syllabus. *You will be tested on the syllabus alone*, so it is vital that you are familiar with it.

There are books specifically produced to support your studies that provide coverage of all the syllabus areas, however you should be prepared to read around the subject. This is important particularly if you feel that further information is required to fully understand a topic or an alternative viewpoint is sought. The reading list which can be found with the syllabus provides valuable suggestions.

#### Note the assumed knowledge

For the Advanced Diploma in Financial Planning, candidates are assumed to have studied the relevant units of the Diploma in Financial Planning or the equivalent. This knowledge is set out on the relevant syllabus.

#### Read widely

If you do not have experience in advising clients whose financial needs are relatively sophisticated, *it is quite unrealistic to expect that the study of a single textbook will be sufficient to meet all your requirements*. While books specifically produced to support your studies will provide coverage of all the syllabus areas, you should be prepared to read around the subject. This is important, particularly if you feel that further information is required to fully understand a topic or an alternative viewpoint is sought. It is vital that your knowledge is widened beyond the scope of one book. The reading list which can be found with the syllabus provides valuable suggestions.

**Make full use of the Examination Guide**

This Examination Guide contains a full examination paper and model answers. The model answers show the types of responses the examiners are looking for and which would achieve maximum marks, *however, you should note that there are alternative answers to some question parts which would also gain high marks.* For the sake of clarity and brevity not all of these alternative answers are shown.

This guide and previous Examination Guides can be treated as ‘mock’ examination papers. Attempting them under examination conditions as far as possible, and then comparing your answers to the model ones, should be seen as an essential part of your exam preparation. The examiner’s comments on candidates’ actual performance in each question provide further valuable guidance. You can purchase copies of the most recent Examination Guides online at [www.cii.co.uk](http://www.cii.co.uk). CII members can download free copies of older Examination Guides online at [www.cii.co.uk/knowledge](http://www.cii.co.uk/knowledge).

**Know the layout of the tax tables**

Familiarise yourself with the information contained within the tax tables printed at the back of each Examination Guide. These tax tables will be provided to candidates as part of the examination paper. The tax tables enable you to concentrate on answering the questions without having to worry about remembering all the information. *Please note that you are not allowed to take your own tax tables into the examination.*

**Know the structure of the examination**

Assessment is by means of a three-hour written paper in two sections. All questions are compulsory:

**Section A** consists of one case study, worth 80 marks. You will be expected to carry out a variety of tasks, after analysing the information provided.

**Section B** consists of two shorter case studies worth a total of 80 marks. Again you will be expected to carry out a variety of tasks based upon the information provided.

Each question part will clearly show the maximum marks which can be earned.

**Appreciate the standard of the examination**

Candidates must demonstrate that they are capable of advising clients *whose overall levels of income and capital require a more sophisticated scheme of investment* than is normally prepared by a level 4 qualified adviser. These clients require a critical appraisal of the various financial planning options available to them.

**Read the Assessment information and Exam policies for candidates**

The details of administrative arrangements and the regulations which form the basis of your examination entry are available online at [www.cii.co.uk/qualifications/assessment-information/introduction/](http://www.cii.co.uk/qualifications/assessment-information/introduction/). This is *essential reading* for all candidates. For further information contact Customer Service.

## In the examination

### The following will help:

#### Spending your time in accordance with the allocation of marks:

- The marks allocated to each question part are shown on the paper;
- If a question has just two marks allocated, there are likely to be only one or two points for which the examiner is looking for, so a long answer is wasting valuable time.
- Conversely, if a question has 12 marks allocated, a couple of lines will not be an adequate answer. Always remember that if the paper is not completed, your chances of passing will be reduced considerably.
- Do not spend excessive time on any one question; if the time allocation for that question has been used up, leave some space, go on to the next question and return to the incomplete question after you have completed the rest of the paper, if you have time.

#### Take great care to answer the question that has been set.

- Many candidates leave the examination room confident that they have written a 'good' paper, only to be surprised when they receive a disappointing result. Often, the explanation for this lies in a failure to think carefully about what the examiner requires before putting pen to paper.
- Highlighting key words and phrases is a technique many candidates find useful.
- The model answers provided in this Examination Guide would gain full marks. Alternative answers that cover the same points and therefore answer the question that has been asked would also gain full marks.

#### Tackling questions

Tackle the three questions in whatever order feels most comfortable. Generally, it is better to leave any questions which you find challenging until you have attempted the questions you are confident about. Candidates should avoid mixing question parts, (for example, 1(a)(i) and (ii) followed by 2(b)(ii) followed by 1(e)(i)) as this often leads to candidates unintentionally failing to fully complete the examination paper. This can make the difference between achieving a pass or a narrow fail.

It is vital to label all parts of your answer correctly as many questions have multiple parts to them (for example, question 1(a) may have parts (i), (ii) and (iii)). Failure to fully distinguish between the separate question parts may mean that full credit cannot be awarded. It is also important to note that a full answer must be given to each question part and candidates should not include notes such as 'refer to answer given in 1(b)(i)'.

**Answer format**

Unless the question requires you to produce an answer in a particular format, such as a letter or a report, you should use ‘bullet points’ or short paragraphs. The model answers indicate what is acceptable for the different types of question.

Where you are asked to perform a calculation, it is important to show **all** the steps in your answer. The majority of the marks will be allocated for demonstrating the correct method of calculation.

Provided handwriting is legible, candidates will **not** lose marks if it is ‘untidy’. Similarly, marks are not lost due to poor spelling or grammar.

**Calculators**

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 alphabetical or numerical data and/or formulae is prohibited. You may use a financial or scientific calculator, provided it meets these requirements. The majority of the marks will be allocated for demonstrating the correct method of calculation.

## EXAMINERS' COMMENTS

### Candidates' overall performance

Overall, candidates performed well in this paper and in almost every question their answers aligned with the requirements of the question.

This examination paper tested content from across the syllabus and was constructed to ensure all candidates would have the opportunity to perform to a pass standard, while also offering candidates the capability to excel. The paper tested a couple of areas of the syllabus for the first time and in general, candidates performed adequately on these new areas, suggesting relatively robust revision by candidates.

It was pleasing to see, in the calculation questions, candidates showing their workings the majority of the time, which allowed an appropriate number of marks to be awarded to those who had a basic grasp of the relevant formulae but were not able to perform the calculation longhand in exam conditions.

Where candidates did not perform as well, there was a proclivity for repetition of the same points several times within a question part as well as a tendency to write vague and generic content, often including truisms or duplication of facts stated in the respective case studies, in the hope that by writing more they might be awarded a greater number of marks.

It was also pleasing to see that in general, candidates answering with a succinct and efficient style were more effective in achieving marks. As the model answers illustrate, marks are awarded for specific points and a focused, bullet point-style answer will often achieve more highly than an expansive narrative.

### Question 1

In part (a) candidates performed very well. The question was designed to present candidates with a smooth introduction to the exam, allaying any nerves and offering them the opportunity to gain some straightforward initial marks.

In part (b) overall candidates performed adequately. Part (b)(i) was an area tested for the first time and candidates generally did not perform well, with most attempting only a small number of distinct points, which were often those relating to a real estate investment trust (REIT) and not a property authorised investment fund (PAIF) which was asked for in the question.

In part (b)(ii), candidates generally performed well with most demonstrating a good knowledge of the tax treatment. The comprehensive nature of the model answer saw most candidates achieving marks for recognising the respective treatment of interest and other income. Candidates who did not perform well often assumed the wrong tax status for Gavin or stated the tax treatment for only one or two components and therefore their answers were not aligned with the requirements of the question.

In part (c) candidates performed well. Most candidates demonstrated a good knowledge of the respective formulae in parts (c)(i) and (c)(ii). In part (c)(iii) almost all candidates correctly identified the dividend cover is higher as it followed from their answer to part (c)(ii).

In part (d) candidates did not perform well. While most candidates gained two or three marks in part (d)(i), their answers to part (d)(ii) were too vague. Sequencing risk was introduced into the paper for the first time as it is an increasing relevant topic and is moving into the mainstream of investment planning. Many candidates gave superficial explanations that suggest they know of the term but do not know how it operates, often confusing it with an explanation of market movements or phased investment into a market.

Part (e) was answered adequately by candidates. In part (e)(i) most gained two or three out of the six marks available. In part (e)(ii), most candidates gained marks for 'trading costs', 'potential tax liabilities' and 'timing of rebalancing/market timing', but to have achieved more marks candidates needed to link their answers to the case study, for example, 'whether existing income will be affected', 'ability to rebalance PAIF/EIS' and the 'on-going suitability of existing funds/asset allocation'.

Part (f) performed well in this question, possibly as it is relatively topical following the changes in the Autumn Budget 2017.

In part (g) candidates performed very well, with the majority attaining maximum marks in part (g)(i). In general, candidates understood how to calculate the return although some candidates did not know how to correctly treat income paid out and capital paid in and therefore did not gain the available marks.

## **Question 2**

Overall candidates performed well in part (a). Almost every candidate gained the available marks for part (a)(i), although a few candidates did not gain the mark for stating which socially responsible investing (SRI) principle was being used by the fund. In part (a)(ii), candidates gained well across the available marks, demonstrating a broad knowledge of SRI.

In part (b) candidates performed well with most candidates gaining from across all of the available marks in question parts (b)(i) and (ii), which are fundamental principles of investment and tested regularly. The interpretation of parts (b)(i) and (b)(ii) in the subsequent part (b)(iii) was answered well by most candidates, with the better prepared candidates gaining the mark for recognition of the specific significance of negative beta.

In part (c) candidates did not perform well. Most candidates achieved one or two marks out of the six available in part (c)(i) and candidates who did not perform well stated the general eligibility rules for an ISA. It is important to read a question carefully before answering to ensure you answer the question set. In part (c)(ii), most candidates achieved one or two marks, with many candidates stating a diverse range of investment products, most of which are not permissible investments within any ISA.

In part (d) candidates performed adequately. Most candidates gained all of the available marks in part (d)(i). In part (d)(ii), too many candidates stated 12%, simply repeating the figure from the case study, whereas you needed to state that it equated to a 12p dividend per share per annum. Also, in part (d)(ii), many candidates did not gain the mark for 'irredeemable equalling no maturity date', instead stating that they could never be redeemed or that the holder was the party responsible for redeeming them.

In part (d)(iii), those candidates who did not attain the 12p dividend mark in part (d)(ii) rarely went on to attain the mark for  $6p \times 2$ , despite the data being stated clearly in Table 2 of the case study. It is fundamental that candidates read the questions including the case study carefully when answering the questions. In part (d)(iv), most candidates gained the mark for 'may be unable to pay or maintain dividends' but only a small number of better prepared candidates gained the mark for 'capital loss if cancelled/repurchased'.

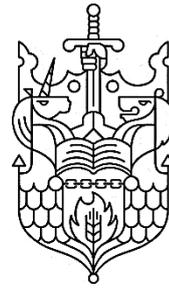
### Question 3

In part (a) candidates performed well. Given the potential complexity of part (a)(i), it was pleasing to see the candidates performing competently in this question part. The candidates who did not perform well often did not show sufficient stages of the required calculation or provided standard examples of normal distributions for standard deviation. In part (a)(ii), most candidates gained three to five out of the six available marks, with those candidates who did not perform well providing definitions of beta or – as with part (a)(i) - explanations of normal distribution for standard deviation and not the differences between the two as measures of risk.

In part (b) candidates performed adequately. In part (b)(i), the majority of candidates gained three to four marks, with almost all candidates gaining the mark for 'debt costs rise/lower profitability'. In part (b)(ii), those candidates who simply answered, 'hedge against inflation' did not achieve many marks but most candidates gained the marks for 'higher share price' and 'resulting in higher prices', with better prepared candidates mentioning the mark for 'equities have pricing power/higher profits'.

In part (b)(iii), most candidates only gained the mark around issuance/supply and demand. As this question combined macroeconomics and index-linked fixed interest securities, overall candidate performance suggests a requirement for greater knowledge in these areas of the syllabus. Some better prepared candidates were still able to gain from across the marks available.

In part (c) candidates performed well overall. This was despite less better performance in part (c)(i), which was not attempted by some candidates and answered incorrectly by several others, with candidates confusing current and capital account. Better prepared candidates were able to perform well, and a pleasing number achieved the maximum marks available. In part (c)(ii), most candidates gained at least three out of the four marks available. Better prepared candidates gained the marks for 'rising interest rates' and 'capital flight out of the UK'. These were achieved by those candidates who had revised this area of the syllabus and as with part (b)(iii). Part (c) reinforces the relevance of macroeconomics as a core component of the syllabus and an area for robust revision.



Chartered  
Insurance  
Institute

# AF4

## Advanced Diploma in Financial Planning

### Unit AF4 – Investment planning

October 2018 examination

#### SPECIAL NOTICES

All questions in this paper are based on English law and practice applicable in the tax year 2018/2019, unless stated otherwise in the question, and should be answered accordingly.

It should be assumed that all individuals are domiciled and resident in the UK unless otherwise stated.

#### Instructions

- Three hours are allowed for this paper.
- **Do not begin writing until the invigilator instructs you to.**
- **Read the instructions on page 3 carefully before answering any questions.**
- Provide the information requested on the answer book and 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.**

## Unit AF4 – Investment planning

### Instructions to candidates

#### Read the instructions below before answering any questions

- **Three hours** are allowed for this paper which carries a total of 160 marks as follows:
- Section A: 80 marks
- Section B: 80 marks
- You are advised to spend approximately 90 minutes on Section A and 90 minutes on Section B.
- 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.
- Read carefully all questions and information provided before starting to answer. Your answer will be marked strictly in accordance with the question set.
- You may find it helpful in some places to make rough notes in the answer booklet. If you do this, you should cross through these notes before you hand in the booklet.
- It is important to show all steps in a calculation, even if you have used a calculator.
- 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.
- Tax tables are provided at the back of this question paper.
- Answer each question on a new page and leave six lines blank after each question part.

**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.**

## SECTION A

This question is compulsory and carries 80 marks

## Question 1

Read carefully all information provided in the case study before attempting the questions. Your answers should take into account the clients' circumstances as set out in the case study. Please carry out ALL of the tasks (a), (b), (c), (d), (e), (f) and (g) which follow.

Gavin, aged 56, and his spouse Sasha, aged 54, have recently sold their business and received net proceeds of £1,600,000.

Gavin and Sasha would like to generate a net income of £100,000 per annum, until Gavin reaches age 65, whereupon his State and private pension provisions will commence, and their net income requirement will reduce to £70,000 per annum. At that point Gavin and Sasha plan to withdraw a capital sum from the portfolio to purchase an additional property.

Sasha holds two Enterprise Investment Scheme (EIS) investments. She understands the basic concept of these investments and would like to invest some of the sale proceeds into similar, new investments.

Gavin holds a Stocks and Shares ISA, which contains two FTSE 250 Index listed equities. The current value of Gavin's ISA is £220,000, although he has not reviewed the plan for several years.

Financial details of the two equities are as per the following table:

Table 1

<b>Security</b>	Grey Square plc	Amber Triangle plc
<b>Sector</b>	Retailer	Retailer
<b>Number of shares in issue</b>	84,000,000	130,000,000
<b>Profit attributable to shareholders</b>	£13,250,000	£41,800,000
<b>Share price</b>	112p	267p
<b>Dividend per share</b>	6p	14p

Gavin also holds a property authorised investment fund (PAIF) on a non-ISA basis. Details of the PAIF's returns over the previous year are as per the following table:

Table 2

<b>Value at 1 January</b>	<b>New money invested on 31 March</b>	<b>Income paid out on 30 June</b>	<b>Value at 31 December</b>
£105,000	£20,000	£3,200	£122,800

Gavin and Sasha want to use the sale of their business as a catalyst to arrange a review of their investments, with particular attention paid to rebalancing the assets within Gavin's ISA and establishing an outline investment strategy for their current and planned future needs.

Both Gavin and Sasha believe that they have a good knowledge of financial markets although they are keen to understand more about how their investment needs can be achieved, as well as the related risks.

## Questions

To gain maximum marks for calculations you **must** show **all** your workings and express your answer to **two** decimal places.

- (a) Outline the main factors that a financial adviser would take into consideration when constructing an investment portfolio to meet Gavin and Sasha's needs. (8)
- (b) (i) State the main conditions that must be met for a property fund to qualify as a property authorised investment fund (PAIF). (6)
- (ii) State the tax treatment of the three income components of a PAIF, if the PAIF is used to generate some of the income requirement. Assume Gavin is a higher rate taxpayer. (8)
- (c) (i) Calculate, **showing all your workings**, the basic earnings per share for Grey Square plc. (3)
- (ii) Calculate, **showing all your workings**, the dividend cover for Amber Triangle plc. (4)
- (iii) Comment on Amber Triangle's dividend cover, given in your answer to **part (c)(ii)** above, if the sector average dividend cover is 1.8. (3)
- (d) (i) Identify **three** additional risks to which Gavin would remain exposed, if he retained the direct equities rather than sold them and re-invested into multi-asset collective funds. (3)
- (ii) Explain to Gavin and Sasha what is meant by sequencing risk and its effects on an investment portfolio, given the need to generate an income from the investment of the sale proceeds. (5)

- (e) (i) Explain the main objectives of the rebalancing process. (6)
- (ii) Identify **ten** main issues that a financial adviser should consider when rebalancing the portfolio once an investment portfolio is set up and generating an income in line with Gavin and Sasha's needs. (10)
- (f) Explain the subscription rules and tax treatment of any new investment that Sasha might make if she decided to subscribe to a new Enterprise Investment Scheme. (10)
- (g) (i) Calculate, **showing all your workings**, the money-weighted rate of return (MWR) for the PAIF over the twelve-month period shown in **Table 2**. (10)
- (ii) Explain briefly why the MWR is not considered appropriate when evaluating and comparing different portfolio returns and suggest a more suitable alternative return measure. (4)

**Total marks available for this question: (80)**

## SECTION B

Both questions in this section are compulsory and carry an overall total of 80 marks

## Question 2

Read carefully all information provided in the case study before attempting the questions. Your answers should take into account the client's circumstances as set out in the case study. Please carry out ALL of the tasks (a), (b), (c) and (d) which follow.

John is recently widowed. His wife, Priya, had worked as an aid worker for a major charity and had a Stocks and Shares ISA investment portfolio within which she selected the funds using Socially Responsible Investment (SRI) principles.

John is considering whether he should sell two of the investments within the ISA, as shown in **Table 1** below.

Global Issues Trust is a UK listed investment trust which aims to invest in companies that are providing solutions to tackling global issues. Affordable Housing Trust is a UK listed Real Estate Investment Trust that owns and manages several affordable housing developments.

Table 1

	Beta	Actual 1 year return	Expected 1 year market return	Standard deviation	Risk free rate of return	Sharp ratio	Alpha
<b>Global Issues Trust</b>	1.4	12%	8%	22	0.25%	0.53	-
<b>Affordable Housing Trust</b>	-0.5	6%	8%	8	0.25%	-	9.63

Priya's ISA is valued at £45,000 of which £4,300 is held in an Innovative Finance ISA.

Priya also owned some 12% cumulative irredeemable preference shares, as shown in **Table 2** below. John would like to understand the features of this investment and the potential risks.

Table 2

Issuer	Holding	Issue price	Current price	Dividend
<b>Ethical Insurance plc</b>	10,000	100p	160p	6p, payable half-yearly

**Questions**

To gain maximum marks for calculations you **must** show **all** your workings and express your answer to **two** decimal places.

- (a) (i) Explain briefly to John the difference between positive screening and negative screening with respect to socially responsible investing, and state which approach is being used by the Global Issues Trust. (3)
- (ii) Explain to John **four** potential drawbacks of using Socially Responsible Investing other than investment performance. (4)
- (b) (i) Calculate, **showing all your workings**, the Alpha for the Global Issues Trust. (5)
- (ii) Calculate, **showing all your workings**, the Sharpe ratio for Affordable Housing Trust. (3)
- (iii) Explain why you would recommend John retains Affordable Housing Trust rather than Global Issues Trust, given the Alpha, Beta and Sharpe ratios of Global Issues Trust and Affordable Housing Trust. (5)
- (c) (i) State the information John would have to provide when requesting an Additional Permitted Subscription in respect of Priya's ISA. (6)
- (ii) State the qualifying investments that may be held within an Innovative Finance ISA. (3)
- (d) (i) Explain to John the main features of preference shares compared to ordinary shares. (3)
- (ii) Explain to John the investment implications of the three stated features of the Ethical Insurance plc preference shares. (3)
- (iii) Calculate, **showing all your workings**, the dividend yield for the Ethical Insurance plc preference shares. (3)
- (iv) Explain **two** risks of continuing to invest in the Ethical Insurance plc preference shares. (2)

**Total marks available for this question: 40**

**Question 3**

Read carefully all information provided in the case study before attempting the questions. Your answers should take into account the client's circumstances as set out in the case study. Please carry out ALL of the tasks (a), (b) and (c) which follow.

Nazan, an investment adviser within an authorised advisory firm, has met with a new retail client who is seeking advice about her investments. Based upon the client's objectives, Nazan believes that a UK multi-asset fund may be suitable and is assessing Many Assets Fund as a potential investment.

Financial data for this fund is as per the following table:

	<b>Many Assets Fund</b>		
<b>Beta</b>	1.4		
<b>Returns over Previous 3 years</b>	3.2%	-0.8%	4.1%

The fund is comprised of cash, fixed interest, equities and physical commodities.

The client believes that the UK economy is deteriorating and is concerned about the impact upon any potential investment in the fund of rising interest rates and higher inflation. The client is also concerned about the impact upon the UK's balance of payments of a worsening economic position.

**Questions**

To gain maximum marks for calculations you **must** show **all** your workings and express your answers to **two** decimal places.

- (a) (i) Calculate, **showing all your workings**, the standard deviation using the returns data for the previous three years. (10)
- (ii) Explain **six** relative differences between standard deviation and Beta in terms of how they measure risk. (6)
- (iii) Explain briefly what Many Assets Fund's Beta means in terms of potential investment returns. (3)
- (b) (i) Explain the potential impact of rising interest rates upon fixed interest and equities asset classes held within Many Assets Fund. (4)
- (ii) Explain **two** reasons why Many Assets Fund may increase its exposure to its equities and commodities asset classes in response to rising inflation. (4)
- (iii) State **three** reasons why the price of index-linked fixed interest securities may fall even if inflation is rising and expected to continue to rise. (3)
- (c) (i) Describe briefly what is meant by current account and capital account. (6)
- (ii) Outline **four** potential economic consequences of the current account and capital account being in deficit over the medium to long-term. (4)

**Total marks available for this question: 40**

**NOTE ON MODEL ANSWERS**

The model answers given are those which would achieve maximum marks. However, there are alternative answers to some question parts which would also gain high marks. For the sake of clarity and brevity not all of these alternative answers are shown. An oblique (/) indicates an equally acceptable alternative answer.

**Model answer for Question 1**

- (a)
- Attitude to risk.
  - Capacity for loss.
  - Other assets/income/future inheritance (*receive not give*).
  - Emergency fund/short term cash requirement.
  - Tax status.
  - Time horizon/longevity/state of health.
  - Ethical preferences.
  - Amount required for property purchase.
- (b) (i) *Candidates would have gained full marks for any six of the following:*
- At least 60%;
  - of income;
  - from exempt property business.
  - Value of property assets must be at least 60% of total assets.
  - Shares widely held.
  - No corporate investor;
  - holding 10% (*or more of net asset value*).
- (ii) **Dividend income**
- Dividend income paid gross;
  - and taxable at 32.5%;
  - once dividend allowance exceeded.
- Property Income Distribution (PID)/exempt**
- Property Income Distribution (PID) exempt paid net of basic rate tax/20%;
  - and taxable at further 20%/40% in total;
  - once personal saving allowance exceeded.
- Interest/other income**
- Interest/other income paid gross;
  - but taxable at 40%.

- (c) (i)  $\pounds 13,250,000 / 84,000,000 = 15.7738095 = 15.77\text{p}$
- (ii)  $\pounds 41,800,000 / 130,000,000 = 32.153846 = 32.15\text{p}$   
 $32.15 / 14 = 2.2964857 = 2.3\text{x}$
- (iii) *Candidates would have gained full marks for any three of the following:*
- Dividend cover is higher;
  - retaining greater proportion of earnings/reserves/investing more.
  - More sustainable/secure.
  - May be distorted by one-off/other factors.
- (d) (i)
- Non-systematic/stock/market risk.
  - No Financial Services Compensation Scheme (FSCS) protection available.
  - Correlation/sector risk/diversification.
- (ii) *Candidates would have gained full marks for any five of the following:*
- Impact of volatility/fluctuation;
  - on the order and;
  - timing/frequency of withdrawals;
  - and sustainability of future income;
  - long-term impact on capital value;
  - greater in early years.
- (e) (i)
- Realign a portfolio to its original asset allocation/weighting;
  - to match attitude to risk;
  - capacity for loss.
  - Review of individual funds/correct any style drift.
  - Invest cash.
  - Adjust portfolio to deal with any change in their circumstances/income level/needs/objectives.
- (ii)
- Trading costs.
  - Whether to retain/alter benchmark.
  - Potential tax liabilities.
  - Regulatory/legislation issues.
  - Is rebalancing automatic/manual.
  - Frequency of rebalancing.
  - Whether existing income will be affected.
  - Liquidity/ability to rebalance property authorised investment fund (PAIF)/Enterprise Investment Scheme (EIS).
  - Timing of rebalancing/market timing.
  - On-going suitability of existing funds/asset allocation.

(f) *Candidates would have gained full marks for any ten of the following:*

- Can invest up to £1,000,000;
- if excess over £1,000,000 up to £2,000,000;
- the balance must be in knowledge-intensive business.
  
- 30% Income Tax relief;
- up to level of Sasha's Income Tax liability.
- Can carry back Income Tax relief to previous tax year.
  
- Re-investment relief; (*deferral/rollover relief*)
- available if invests within three years of sale of business/disposal;
- exempt from Capital Gains Tax upon sale;
- if held for three years.
  
- Qualify for business relief/exempt from Inheritance Tax;
- if held for two years.

(g) (i)  $£3,200 + £122,800 - £105,000 - £20,000 = £1,000$

$$£105,000 + (£20,000 \times 9/12ths) = £120,000$$

$$1,000 / £120,000 \times 100 = 0.83333333 = 0.83\%$$

- (ii)
- Strongly influenced by cash flows/timing;
  - outside control of manager;
  - doesn't identify whether returns are due to ability of manager.
  - Time-weighted return (TWR).

### Model answer for Question 2

- (a) (i)
- Positive screening invests in companies that meet laid down criteria.
  - Negative screening avoids companies that fail to meet criteria.
  - Global Issues Trust is using a positive screen.
- (ii) *Candidates would have gained full marks for any four of the following:*
- Less diversification due to avoiding certain areas/fewer investment opportunities.
  - More expensive.
  - Approach differs/not consistent/not aligned with John's Socially Responsible Investment (SRI) view.
  - Less research available.
  - Higher risk/higher tracking error/risk not aligned with John's attitude to risk.
  - Screening rules out growth/income.
- (b) (i)  $12 - [0.25 + 1.4 \times (8 - 0.25)] = 12 - 11.1 = 0.9$
- (ii)  $6 - 0.25 / 8 = 0.72$
- (iii)
- Higher alpha/manager added more value.
  - Higher Sharpe/better risk adjusted returns.
  - Lower beta/less market risk.
  - Negative beta/good diversification.
  - Likely higher income.
- (c) (i)
- Priya's National Insurance number/confirmation of no National Insurance number of Priya.
  - Date of birth/birth certificate;
  - and date of death of Priya/death certificate.
  - Proof of Marriage/certificate.
  - Full name;
  - and address.
- (ii)
- Debt based securities/bonds and debentures/loans to companies.
  - Cash.
  - Peer to peer lending.

- (d) (i)
  - Fixed dividend.
  - Higher priority in payment/winding-up.
  - Non-voting.
- (ii)
  - 12% = 12p dividend per share.
  - Cumulative = if miss preference dividend must make it up before paying ordinary dividends.
  - Irredeemable = no maturity date.
- (iii)  $6 \times 2 = 12$   
 $12 / 160$   
 $= 0.075 \times 100 = 7.5\%$
- (iv)
  - Capital loss if cancelled/repurchased.
  - May be unable to pay/maintain dividends/no dividend paid for year(s).

**Model answer for Question 3**

(a) (i) Mean return =  $(3.2 - 0.8 + 4.1) / 3 = 2.17$

$$\begin{aligned} & (3.2 - 2.17)^2 + (-0.8 - 2.17)^2 + (4.1 - 2.17)^2 \\ &= (1.03)^2 + (-2.97)^2 + (1.93)^2 \\ &= 1.06 + 8.82 + 3.72 \\ &= 13.6 \end{aligned}$$

$$\sqrt{13.6/3} = \sqrt{4.53} = 2.13$$

**(ii) Measure**

- Beta measures market risk;
- standard deviation measures fund risk/does not measure market risk.

**How they measure**

- Beta measures volatility;
- standard deviation does not/measures total risk.

**Benchmark**

- Beta is relative to market;
- standard deviation is not/is based upon actual return.

- (iii)
- Move in same direction as market/positive correlation.
  - More volatile than/sensitive to market movement.
  - Will out-perform in rising market/under-perform in falling market.

**(b) (i) Fixed interest**

- Yields rise;
- capital values fall.

**Equities**

- Debt costs rise/lower profitability;
- dividends/share prices fall.

- (ii)
- Equities has pricing power/higher profits;
  - higher share price.

- Commodities demand increases;
- resulting in higher prices.

**(iii) Candidates would have gained full marks for any three of the following:**

- Interest rates rising faster than inflation.
- Increased issuance to fund budget deficit/fiscal policy/supply and demand/credit downgrade.
- Inflation expectations are falling/lower than expected.
- Consumer Price Index (CPI)/Retail Price Index (RPI) difference.

(c) (i) *Candidates would have gained full marks for any six of the following:*

**Current account**

- Imports minus;
- exports/balance of payments;
- in goods & services;
- plus receipt from overseas income generating assets.

**Capital account**

- Movement of all monies/assets;
- into country;
- out of country.

(ii) *Candidates would have gained full marks for any four of the following:*

- Rising interest rates.
- Economy growth falls.
- Currency devaluation.
- Capital flight out of UK.
- Unemployment rises.
- Inflation increases.

**All questions in the April 2019 paper will be based on English law and practice applicable in the tax year 2018/2019, unless stated otherwise and should be answered accordingly.**

**The Tax Tables which follow are applicable to the October 2018 and April 2019 examinations.**

**INCOME TAX**

<b>RATES OF TAX</b>	<b>2017/2018</b>	<b>2018/2019</b>
Starting rate for savings*	0%	0%
Basic rate	20%	20%
Higher rate	40%	40%
Additional rate	45%	45%
Starting-rate limit	£5,000*	£5,000*
Threshold of taxable income above which higher rate applies	£33,500	£34,500
Threshold of taxable income above which additional rate applies	£150,000	£150,000

Child benefit charge:

1% of benefit for every £100 of income over	£50,000	£50,000
---	---------	---------

*\*not applicable if taxable non-savings income exceeds the starting rate band.*

Dividend Allowance		£2,000
Dividend tax rates		
Basic rate		7.5%
Higher rate		32.5%
Additional rate		38.1%
Trusts		
Standard rate band		£1,000
Rate applicable to trusts		
- dividends		38.1%
- other income		45%

**MAIN PERSONAL ALLOWANCES AND RELIEFS**

Income limit for Personal Allowance §	£100,000	£100,000
Personal Allowance (basic)	£11,500	£11,850
Married/civil partners (minimum) at 10% †	£3,260	£3,360
Married/civil partners at 10% †	£8,445	£8,695
Transferable tax allowance for married couples/civil partners	£1,150	£1,190
Income limit for Married couple's allowance †	£28,000	£28,900
Rent a Room relief	£7,500	£7,500
Blind Person's Allowance	£2,320	£2,390
Enterprise Investment Scheme relief limit on £1,000,000 max**	30%	30%
Seed Enterprise Investment relief limit on £100,000 max	50%	50%
Venture Capital Trust relief limit on £200,000 max	30%	30%

§ the Personal Allowance reduces by £1 for every £2 of income above the income limit irrespective of age (under the income threshold).

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

\*\* maximum for 'standard' investment but for 'knowledge intensive' investment, the limit is £2,000,000.

Child Tax Credit (CTC)		
- Child element per child (maximum)	£2,780	£2,780
- family element	£545	£545
Threshold for tapered withdrawal of CTC	£16,105	£16,105

## NATIONAL INSURANCE CONTRIBUTIONS

Class 1 Employee	Weekly
Lower Earnings Limit (LEL)	£116
Primary threshold	£162
Upper Earnings Limit (UEL)	£892

Total earnings £ per week	CLASS 1 EMPLOYEE CONTRIBUTIONS
Up to 162.00*	Nil
162.01 – 892.00	12%
Above 892.00	2%

*\*This is the primary threshold below which no NI contributions are payable. However, the lower earnings limit is £116 per week. This £116 to £162 band is a zero-rate band introduced in order to protect lower earners' rights to contributory State benefits e.g. the new State Pension.*

Total earnings £ per week	CLASS 1 EMPLOYER CONTRIBUTIONS
Below 162.00**	Nil
162.01 – 892	13.8%
Excess over 892.00	13.8%

*\*\* Secondary earnings threshold.*

<b>Class 2 (self-employed)</b>	Flat rate per week £2.95 where profits exceed £6,205 per annum.
<b>Class 3 (voluntary)</b>	Flat rate per week £14.65.
<b>Class 4 (self-employed)</b>	9% on profits between £8,424 - £46,350. 2% on profits above £46,350.

## PENSIONS

TAX YEAR	LIFETIME ALLOWANCE
2006/2007	£1,500,000
2007/2008	£1,600,000
2008/2009	£1,650,000
2009/2010	£1,750,000
2010/2011	£1,800,000
2011/2012	£1,800,000
2012/2013	£1,500,000
2013/2014	£1,500,000
2014/2015	£1,250,000
2015/2016	£1,250,000
2016/2017	£1,000,000
2017/2018	£1,000,000
2018/2019	£1,030,000

### 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.

### ANNUAL ALLOWANCE

TAX YEAR	ANNUAL ALLOWANCE
2011/2012	£50,000
2012/2013	£50,000
2013/2014	£50,000
2014/2015	£40,000
2015/2016	£40,000~
2016/2017	£40,000*
2017/2018	£40,000*
2018/2019	£40,000*

~ increased to £80,000 for pension input between April - 8 July 2015. If not used, can be carried forward to pension input period of 9 July 2015 - 6 April 2016, subject to a maximum of £40,000.

\*tapered at a rate of £1 for every £2 of adjusted income in excess of £150,000 where threshold income exceeds £110,000.

MONEY PURCHASE ANNUAL ALLOWANCE	2017/2018	2018/2019
	£4,000	£4,000

### ANNUAL ALLOWANCE CHARGE

20% - 45% determined by the member's taxable income and the amount of total pension input in excess of the annual allowance or money purchase annual allowance.

## CAPITAL GAINS TAX

EXEMPTIONS	2017/2018	2018/2019
Individuals, estates etc	£11,300	£11,700
Trusts generally	£5,650	£5,850
Chattels proceeds (restricted to five thirds of proceeds exceeding limit)	£6,000	£6,000
<b>TAX RATES</b>		
Individuals:		
Up to basic rate limit	10%	10%
Above basic rate limit	20%	20%
Surcharge for residential property and carried interest	8%	8%
Trustees and Personal Representatives	20%	20%
Entrepreneurs' Relief* – Gains taxed at:	10%	10%
Lifetime limit	£10,000,000	£10,000,000

*\*For trading businesses and companies (minimum 5% employee or director shareholding) held for at least one year.*

## INHERITANCE TAX

### RATES OF TAX ON TRANSFERS

	2017/2018	2018/2019
Transfers made on death after 5 April 2015		
- Up to £325,000	Nil	Nil
- Excess over £325,000	40%	40%
Transfers made after 5 April 2015		
- Lifetime transfers to and from certain trusts	20%	20%

*A lower rate of 36% applies where at least 10% of deceased's net estate is left to a registered charity.*

### MAIN EXEMPTIONS

Transfers to		
- UK-domiciled spouse/civil partner	No limit	No limit
- non-UK-domiciled spouse/civil partner (from UK-domiciled spouse)	£325,000	£325,000
- main residence nil rate band*	£100,000	£125,000
- UK-registered charities	No limit	No limit

*\*Available for estates up to £2,000,000 and then tapered at the rate of £1 for every £2 in excess until fully extinguished*

Lifetime transfers		
- Annual exemption per donor	£3,000	£3,000
- Small gifts exemption	£250	£250

Wedding/civil partnership gifts by		
- parent	£5,000	£5,000
- grandparent/bride and/or groom	£2,500	£2,500
- other person	£1,000	£1,000

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
- Inheritance Tax payable	100%	80%	60%	40%	20%

Quick succession relief:

	0-1	1-2	2-3	3-4	4-5
- Inheritance Tax relief	100%	80%	60%	40%	20%

## CAR BENEFIT FOR EMPLOYEES

The charge for company car benefits is based on the carbon dioxide (CO<sub>2</sub>) emissions. There is no reduction for high business mileage users.

### For 2018/2019:

- The percentage charge is 13% of the car's list price for CO<sub>2</sub> emissions of 50g/km or less.
- For cars with CO<sub>2</sub> emissions of 51g/km to 75g/km the percentage is 16%.
- For cars with CO<sub>2</sub> emissions of 76g/km to 94g/km the percentage is 19%.
- Cars with CO<sub>2</sub> emissions of 95g/km have a percentage charge of 20% and thereafter the charge increases by 1% for every complete 5g/km to a maximum of 37% (emissions of 190g/km and above).

There is an additional 4% supplement for diesel cars not meeting Euro IV emission standards. However, the maximum charge remains 37% of the car's list price.

**Car fuel** The benefit is calculated as the CO<sub>2</sub> emissions % relevant to the car and that % applied to a set figure (£23,400 for 2018/2019) e.g. car emission 90g/km = 19% on car benefit scale. 19% of £23,400 = £4,446.

1. **Accessories** are, in most cases, included in the list price on which the benefit is calculated.
2. **List price** is reduced for capital contributions made by the employee up to £5,000.
3. **Car benefit** is reduced by the amount of employee's contributions towards running costs.
4. **Fuel scale** is reduced only if the employee makes good **all** the fuel used for private journeys.
5. **All car and fuel benefits** are subject to employers National Insurance contribution's (Class 1A) of 13.8%.

## PRIVATE VEHICLES USED FOR WORK

	2017/2018 Rates	2018/2019 Rates
<b>Cars</b>		
On the first 10,000 business miles in tax year	45p per mile	45p per mile
Each business mile above 10,000 business miles	25p per mile	25p per mile
<b>Motor Cycles</b>	24p per mile	24p per mile
<b>Bicycles</b>	20p per mile	20p per mile

## MAIN CAPITAL AND OTHER ALLOWANCES

2017/2018    2018/2019

Plant & machinery (excluding cars) 100% annual investment allowance (first year)			£200,000	£200,000
Plant & machinery (reducing balance) per annum			18%	18%
Patent rights & know-how (reducing balance) per annum			25%	25%
Certain long-life assets, integral features of buildings (reducing balance) per annum			8%	8%
Energy & water-efficient equipment			100%	100%
Zero emission goods vehicles (new)			100%	100%
Qualifying flat conversions, business premises & renovations			100%	100%
<b>Motor cars:</b> Expenditure on or after 01 April 2016 (Corporation Tax) or 06 April 2016 (Income Tax)				
CO <sub>2</sub> emissions of g/km:	50 or less*	51-110		111 or more
Capital allowance:	100%	18%		8%
	first year	reducing balance		reducing balance

\*If new

## MAIN SOCIAL SECURITY BENEFITS

		2017/2018	2018/2019
		£	£
Child Benefit	First child	20.70	20.70
	Subsequent children	13.70	13.70
	Guardian's allowance	16.70	17.20
Employment and Support Allowance	Assessment Phase		
	Age 16 – 24	Up to 57.90	Up to 57.90
	Aged 25 or over	Up to 73.10	Up to 73.10
	Main Phase		
	Work Related Activity Group	Up to 102.15	Up to 102.15
	Support Group	Up to 109.65	Up to 110.75
Attendance Allowance	Lower rate	55.65	57.30
	Higher rate	83.10	85.60
basic State Pension	Single	122.30	125.95
	Married	195.60	201.45
new State Pension	Single	159.55	164.35
Pension Credit	Single person standard minimum guarantee	159.35	163.00
	Married couple standard minimum guarantee	243.25	248.80
	Maximum savings ignored in calculating income	10,000.00	10,000.00
Bereavement Payment*		2,000.00	2,000.00
Bereavement Support Payment**	Higher rate - First payment	3,500.00	3,500.00
	Higher rate - monthly payment	350.00	350.00
	Lower rate – First payment	2,500.00	2,500.00
	Lower rate – monthly payment	100.00	100.00
Jobseekers Allowance	Age 18 - 24	57.90	57.90
	Age 25 or over	73.10	73.10
Statutory Maternity, Paternity and Adoption Pay		140.98	145.18

\*Only applicable where spouse or civil partner died before 6 April 2017.

\*\* Only applicable where spouse or civil partner died on or after 6 April 2017.

**CORPORATION TAX**

	2017/2018	2018/2019
Standard rate	19%	19%

**VALUE ADDED TAX**

	2017/2018	2018/2019
Standard rate	20%	20%
Annual registration threshold	£85,000	£85,000
Deregistration threshold	£83,000	£83,000

**STAMP DUTY LAND TAX**

	Residential
Value up to £125,000	0%
£125,001 - £250,000	2%
£250,001 and £925,000	5%
£925,001 and £1,500,000	10%
£1,500,001 and over	12%

*Stamp Duty Land Tax (SDLT) is payable in England and Northern Ireland only. Land Transaction Tax (LTT) is payable in Wales and Land and Buildings Transaction Tax (LBTT) is payable in Scotland. The rates for LTT and LBTT are different to the rates shown above.*

*Additional SDLT of 3% may apply to the purchase of additional residential properties purchased for £40,000 or greater.*

*SDLT is charged at 15% on interests in residential dwellings costing more than £500,000 purchased by certain corporate bodies or non-natural persons.*

*First-time buyers benefit from SDLT relief on purchases up to £500,000 when purchasing their main residence. On purchases up to £300,000, no SDLT is payable. On purchases between £300,000 and £500,000, a flat rate of 5% is charged on the balance above £300,000.*