Chartered
Insurance
Institute

AF4

Advanced Diploma in Financial Planning

Unit AF4 – Investment Planning

October 2021 Examination Guide

SPECIAL NOTICES

Candidates entered for the February 2022 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

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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. 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 obtain copies of the two most recent examination guides free of charge at www.cii.co.uk.

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/. This is *essential reading* for all candidates. For further information contact Customer Service.

In the examination

The following will help:

Spend 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 did not perform as well as the previous sitting in June 2021.

The exam tests 'core' and 'peripheral' content from across the syllabus, offering a wide mix of questions from across all seven learning outcomes. This allowed well-prepared candidates the opportunity to perform to a pass standard.

The June 2021 sitting was postponed from earlier in the year and this provided candidates with an extended period for revision. In contrast, many candidates for the October 2021 may have 'rushed' their revision and were not well-prepared. As a consequence, their answers to several question-parts demonstrated superficial knowledge and understanding of the relevant areas of the syllabus.

Across the calculation questions, the majority of candidates showed all the relevant workings and those who did not perform well either used an incorrect value(s) or did not show all of the stages of their working. In some calculation questions, candidates applied values different to those set out in the table of the relevant case study.

In some questions, there was a tendency for candidates to duplicate their answers across different question-parts, for example repeating the distinct points from their answer to part (i) in their answer to part (ii). As review of previous exam guides will show, the same marks are very rarely awarded more than once within a question. Also, there was some evidence of candidates repeating content from previous exam guides, on occasions almost verbatim, for question(s) that were worded similarly to previous paper(s).

In addition, as set out more fully in the respective questions below, a number of candidates either answered the two question-parts the wrong way around or duplicated their answer across both question-parts, in effect hedging their answers.

It was pleasing to see that fewer candidates wrote expansive, narrative-style answers, in favour of more candidates answering with a succinct, bullet-point focused style. This produces a more effective exam technique and in general results in more marks being awarded. This behaviour has been highlighted in previous exam guides and is being adopted by an increasing proportion of candidates in each subsequent sitting. This has contributed to a shift toward more focused, efficient answer scripts.

A well-prepared candidate having undertaken robust revision across the learning outcomes would have been able to achieve the pass standard.

Question 1

In part (a) candidates performed very well, with the majority of candidates achieving all the available marks in part (a)(i). In part (a)(ii), most candidates identified half of the available marks, with better prepared candidates also being awarded the '*only suited to equity'* and on occasions '*doesn't explain source'* marks.

Candidates did not perform well in part (b). In part (b)(i), many candidates included '*market risk*' despite it being excluded from the answer and in part (b)(ii) many candidates duplicated their answers to part (b)(i) despite this again being excluded in the question. Those candidates who did not perform well listed risks not relevant to a UK equities fund, e.g. 'currency risk'; 'duration risk' and 'credit risk'. Candidates did not distinguish between risks that are distinct to open and closed-ended collective funds, and often stated closed-ended risks for open-ended funds and vice versa. Better prepared candidates did identify the distinct risks in both question-parts.

In part (c) candidates performed well. It was pleasing to see in part (c)(i), almost all candidates were awarded maximum marks. In part (c)(ii), candidates performed adequately although a notable proportion of candidates who achieved maximum marks in part (c)(i) were not awarded any marks in part (c)(ii). In part (c)(iii) the majority of candidates synthesised the data from part (c)(ii) to identify both available marks, although some good candidates who had been awarded all the marks in part (c)(ii) then did not get the part (c)(iii) marks, offering an answer that contradicted the values they had correctly calculated in part (c)(ii).

It was pleasing to see candidates performed well in part (d). In part (d)(i) the majority of candidates were awarded all the available marks, however many candidates believed that Clara could subscribe to a Lifetime ISA. In part (d)(ii) candidates performed very well and it was clear that robust revision had been undertaken around the rules of a LISA. Candidates who did not perform well in this question-part either stated general features of a stocks & shares ISA or stated incorrect rules for a LISA, notably the correct criteria for penalty-free withdrawal.

In part (d)(iii) candidates performed adequately. In part (d)(iv) candidates performed well with many being awarded the maximum marks available. It is the second time that the additional permitted subscription (APS) has been tested and it is encouraging to see that candidates performed better on this occasion than the first, which suggests study of previous exam guides is supporting effective revision.

Part (e) was related to question part (b) in that both were testing differences between open and closed-ended collective funds with candidates performing adequately. Given that almost all retail investment products used by investment advisers are collective funds, it is surprising that there is a lack of basic understanding. This suggests that candidate knowledge is superficial which is why this area of the syllabus will continue to be tested regularly. Those candidates who did not perform well in either got the factors the wrong way around, e.g. in part (d)(i) stating open-ended features for an investment trust and closed-ended features for an OEIC, or simply duplicated their answer to part (d)(i) in part (d)(ii).

In part (f) candidates performed very well. This style of question, comparing different types of products, reflects the application of investment planning and is usually well-received by those candidates who are involved in this activity in their daily roles. Most candidates achieved the majority, if not all, of the marks available.

Question 2

In part (a) candidates performed well. As with Question 1 part (f), this style of question has been used before and is answered well by candidates, demonstrating detailed knowledge.

In part (b) candidates performed adequately. In part (b)(i) most candidates gained all the available marks, with only a small number getting the periods the wrong way around, i.e. up to three years before/one year after. In part (b)(ii) candidates performed adequately. The rules of tax-sheltered products such as enterprise investment schemes (EIS) are core content and candidates revise accordingly with a good level of baseline knowledge. However, several candidates did not perform well as they duplicated their answers to part (b)(i) in part (b)(ii).

In part (c) candidates did not perform well. Part (c) was specifically set as a different question to part (b) in order to test seed enterprise investment schemes (SEIS) separately to EIS. However, the majority of candidates did not perform well as they did not know the SEIS tax treatment for capital gains tax (CGT). In addition, many candidates based their answer on Anshul's entire gain being eligible for investment into a SEIS rather than using the correct SEIS limit. While the majority of candidates knew the maximum Income Tax relief that could be claimed, too many candidates applied incorrect rates for the CGT relief, with many candidates using Income Tax rates to calculate CGT reliefs.

In part (d) a high proportion of candidates performed well and correctly connected the case study content with the relevant behaviour to state valid reasons for the behaviours.

In part (e) candidates performed well. This syllabus area was tested for the first-time and it was pleasing to see how well candidates performed in part (e)(i), with the majority being awarded in the upper half of the available marks. Candidates who performed well in part (e)(i) generally then did so in part (e)(ii) although a reasonable number did not perform well in part (b)(ii), stating factors/limitations relating to Modern Portfolio Theory (MPT) or the Capital Asset Pricing Model (CAPM). In part (e)(iii) candidates performed adequately although, as with part (e)(ii), too many candidates simply listed factors/limitations of MPT or CAPM.

Question 3

In part (a) candidates performed well. Return on equity (ROE) and return on capital employed (ROCE) are core formulae that are tested frequently and revised accordingly by candidates. In part (a)(i) the majority of candidates gained the majority of the available marks, with a good proportion being awarded maximum marks. Those candidates who did not perform well omitted the long-term liabilities from the calculation. It was pleasing to see that the majority of candidates expressed the output in percentage terms. In part (a)(ii) almost all candidates gained over half the marks available.

In part (b) candidates performed adequately. In part (b)(i) most candidates were awarded half of the available marks. Candidates who did not perform well either did not show all their workings or added the long-term liabilities to the current liabilities. In part (b)(ii) the majority of candidates were awarded the majority of the available marks.

In part (b)(iii) candidates either performed very well, with several being awarded all of the available marks, or very poorly. For the latter, candidates' answers generally either stated 'assets' and 'liabilities' as the two headings, with many then listing categories of each as would be contained within a factfind or listed various types of assets, including retail investment products and investment asset classes, unrelated to a company's accounts. While AF4 is not an accountancy exam, company accounts are identified at learning outcome level as being within the syllabus and are covered comprehensively within both the R02 and AF4 study texts. Candidates should expect this area of the syllabus to be tested on an occasional basis.

In part (c) candidates performed adequately. In part (c)(i) those that did not perform well generally either stated components of the current account or balance of payments, or listed vague, economic and monetary terms. In part (c)(ii) the majority of candidates were awarded all the available marks, which was surprising as some of these candidates had not gained any marks in part (c)(i) but then achieved all the available marks in part (c)(ii), which suggested they knew the purpose of the capital account but not its components.

In part (c)(iii) candidates did not perform well, with the majority gaining less than half of the available marks. Candidate knowledge of macro-economics is generally poor despite it being identified at learning outcome level and well-covered within the study texts. As in question 2 part (e)(iii), many candidates who did not perform stated factors relating to MPT and CAPM, as well as in part (c)(iii) stated the role of monetary policy within an economy.

In part (d) candidates performed adequately. The majority of candidates were awarded half of the available marks, with some better prepared candidates being awarded all the available marks. A significant number of candidates answered with a list of the individual components that make up the ongoing charge figure (OCF) rather than a description of what is meant by the OCF itself.

Chartered Insurance Institute

AF4

Advanced Diploma in Financial Planning

Unit AF4 – Investment planning

October 2021 examination

SPECIAL NOTICES

All questions in this paper are based on English law and practice applicable in the tax year 2021/2022, 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) and (f) which follow.

Lucy and Clara are new retail clients of an authorised advisory firm. Lucy, aged 38, is a basic rate taxpayer and Clara, aged 40, is a higher rate taxpayer.

Lucy and Clara have been in a civil partnership for several years. They would like to purchase a property together in three years' time. Both are employed and members of workplace pensions via auto-enrolment, although they would like to consider non-pension products to meet their long-term investment needs.

Lucy contributes £100 per month to a Help to Buy ISA and the current value of the plan is £8,000. Clara invests equally in two collective funds within a general investment account (GIA).

Value Opportunities Fund is an open-ended investment company (OEIC) that invests in value-orientated large cap UK equities. Details relating to its recent performance are set out in **Table 1** below.

Table 1

Expected market return	Actual market return	Risk-free rate of return	Actual portfolio return	Portfolio beta
6.2%	4.5%	0.1%	5.1%	1.3

Tech Trust plc is a UK-listed investment trust that invests globally in early-stage and start-up technology companies. Details of its recent performance and asset allocation are set out in **Table 2** below.

Table 2

	UK	North America	Asia	Frontier Markets
Fund Allocation %	15	25	40	20
Fund Performance %	12	-9	-6	8

The contributions to the benchmark's overall return for Tech Trust plc are 1.5% for the UK; 4% for North America; 5% for Asia and 6% for Frontier Markets.

Clara has asked the adviser to explain the difference between an OEIC and an investment trust. She is also confused by all the documentation received from the investment providers and would like to know more about how they are priced.

In addition to the value of their existing investments, Lucy and Clara would like to accumulate at least £25,000 over the next three years in order to assist with the property purchase. They would then like to continue with long-term savings but are reluctant to commit to using only pension products as they do not believe they are flexible enough to meet their needs. Both describe themselves as having a balanced attitude to risk but have never previously discussed the concept of risk in any detail.

Questions

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

(a) (i) Calculate, **showing all your workings**, the alpha for the Value Opportunities Fund. **(6)**

(ii) State **four** limitations of using alpha to measure a fund's performance. **(4)**

(b) (i) Identify and explain briefly **four** main types of investment risk that would be relevant to Clara's investment in the Value Opportunities Fund. *Exclude market risk from your answer.* **(8)**

(ii) Identify and explain briefly **four** additional main types of investment risk that would be relevant to Clara investing in Tech Trust plc. *Exclude those risks contained in your answer to **part (b)(i)** above.* **(8)**

(c) (i) Calculate, **showing all your workings**, the overall return of Tech Trust plc. **(5)**

(ii) Calculate, **showing all your workings**, the relative performance of each of Tech Trust plc's geographical allocations against their respective benchmark returns. **(4)**

(iii) Identify the geographical allocation that has made the greatest impact on Tech Trust plc's performance relative to its benchmark, based upon your answer to **part (c)(ii)** above, and state the reason. **(2)**

(d) (i) State the **maximum** amount that Lucy and Clara could **each** contribute to a Lifetime ISA in its first year and any Government bonus that may be payable. **(3)**

(ii) Explain the main contribution and withdrawal rules for a Lifetime ISA. Exclude your answers to **part (d)(i)** above. **(8)**

(iii) Outline the options available to Lucy in respect of her existing Help to Buy ISA. **(4)**

(iv) State the information that an ISA administrator would require in order to process an additional permitted subscription (APS) request by a surviving civil partner. **(6)**

QUESTIONS CONTINUE OVER THE PAGE

(e) **(i)** Describe the main differences in the **structure** of an OEIC and an Investment Trust. **(8)**

(ii) Describe the main differences in the **pricing** of an OEIC and an Investment Trust. **(8)**

(f) Identify **three** advantages and **three** disadvantages of using a GIA for retirement planning, compared to a workplace pension, to meet Lucy and Clara's needs. **(6)**

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), (d) and (e) which follow.

Anshul, aged 63, is a director and majority shareholder in a manufacturing business. He is considering partial retirement and has received an offer to sell one third of his shareholding for £500,000.

Anshul has a portfolio of collective funds that he has accumulated over at least two decades, mainly from direct offers advertisements. Anshul has told his financial adviser that he does not retain all the correspondence he is sent by the providers, and this makes completion of his self-assessment return difficult. Anshul's financial adviser has recommended previously that these should be consolidated onto a platform although Anshul has not yet proceeded with this recommendation. The previous suitability report highlighted how Stochastic modelling could assist Anshul with his long-term financial planning.

In respect of his financial planning objectives, Anshul wants any investment to be as tax efficient as possible and has asked his adviser to evaluate Enterprise Investment scheme (EIS) and Seed Enterprise investment scheme (SEIS) products. Anshul has not previously invested into an EIS or SEIS.

In recent years, Anshul has been receiving dividends declared by the business at a level of 7% per annum. As Anshul has become used to receiving this level of dividend income, his main objective is to generate a high level of income from any sale proceeds. Capital appreciation is of secondary importance to him due to his residual shareholding in the business.

Anshul's financial adviser has spoken with Anshul's accountant who has indicated that £350,000 of the partial sale would be subject to Capital Gains Tax (CGT).

Questions

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

(a) Identify **six** main benefits to Anshul of consolidating his existing collective funds onto a platform. **(6)**

(b) **(i)** State the time limits within which CGT deferral relief would be available to Anshul on a new investment into an EIS. *Assume that the sale of the shares completes in May 2022.* **(3)**

(ii) Explain briefly the CGT rules of any new investment into an EIS, if the investment were made with the proceeds from the sale of the shares. **(8)**

(c) Calculate, **showing your workings**, the Income Tax and CGT reliefs that could be claimed by Anshul if he invested the **maximum** amount into a new SEIS. **(7)**

(d) Identify **two** factors that are relevant to Anshul, from a behavioural finance perspective and give **one** reason for **each** of these two factors. **(4)**

(e) **(i)** Describe briefly the objective of Stochastic modelling. **(5)**

(ii) State the **three main** inputs required to generate an optimal portfolio via a Stochastic modelling tool. **(3)**

(iii) Identify **four** drawbacks of using a Stochastic modelling tool. **(4)**

Total marks available for this question: 40

QUESTIONS CONTINUE OVER THE PAGE

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), (c) and (d) which follow.

A financial adviser is reading the accounts of two UK-listed companies that have recently been added within a collective fund. Selected financial information for each of the companies is set out in **Table 1** and **Table 2** below.

Table 1

	Forest View plc
Profit before interest & tax	£18,500,000
Interest paid	£2,000,000
Tax paid	£4,200,000
Shareholders' capital	£35,000,000
Reserves	£9,700,000
Long-term borrowing	£22,600,000

Table 2

	Cloud Formation plc
Cash	£3,800,000
Trade debtors	£2,150,000
Current liabilities	£1,400,000
Long-term liabilities	£1,250,000

Both companies have been added by the fund's manager in view of their defensive nature as the manager believes the UK's capital account is likely to deteriorate.

The fund's current factsheet indicates that the Ongoing Charge Figure (OCF) has been reduced following the publication of the latest Assessment of Value Report.

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 return on equity (ROE) for Forest View plc. **(9)**

(ii) Describe briefly what is measured by the ROE metric. **(4)**

(b) **(i)** Calculate, **showing all your workings**, the quick ratio for Cloud Formation plc. **(4)**

(ii) Explain briefly what the ratio shows about Cloud Formation plc's current financial position, based on your calculation in **part (b)(i)** above. **(3)**

(iii) State the **two** main Asset headings within the balance sheet of a company's accounts and list **two** categories of assets that would be found under **each** heading. **(6)**

(c) **(i)** State the **three** main components of the UK's capital account. **(3)**

(ii) State the principal purpose of a capital account surplus within the UK's balance of payments. **(3)**

(iii) Explain briefly the macro-economic role of financial investment within the economy. **(4)**

(d) Describe briefly what is meant by the OCF in respect of a collective fund. **(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) **(i)** 5.1 - [0.1 + 1.3 (4.5 - 0.1)] = -0.72

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

- Doesn't explain source/reason for outperformance.
- Assumes CAPM/market/benchmark/risk-free rate/ is suitable/correct.
- Relative to beta/assumes beta is correct measure of risk.
- Ignores costs/charges.
- Only suited to comparing equity/similar funds.

(b) **(i)** *Candidates would have scored full marks for any eight of the following:*

- **Volatility;**
- Greater degree of movement.
- **Manager;**
- Stock-picking/negative alpha/underperforms.
- **Shortfall;**
- Returns less than needed/target.
- **Style/Concentration;**
- Value out of favour/growth outperforms.
- **Non-systematic/specific;**
- Corporate event.

(ii) *Candidates would have scored full marks for any eight of the following:*

- **Liquidity;**
- Unable to sell/achieve fair price.
- **Pricing;**
- Trades at discount/premium to NAV.
- **Currency;**
- Returns affected by currency movement.
- **Gearing/Interest Rate;**
- Equity returns affected by borrowing/interest rates.
- **Sector;**
- Lack of information/early stage/speculative investment.

(c) **(i)** UK 15% x 12% = 1.8%
North America 25% x -9% = -2.25%
Asia 40% x -6% = -2.4%
Frontier 20% x 8% = 1.6%
Total = -1.25%

(ii) UK 1.5% vs 1.8% = +0.3%
North America 4% vs -2.25% = -6.25%
Asia 5% vs -2.4% = -7.4%
Frontier 6% vs 1.6% = -4.4%

(iii)
- Asia.
- Highest allocation.

(d) **(i)**

Lucy	Clara
• £4,000. • Up to 25%/£1,000 bonus.	• Nil/£0

(ii) *Candidates would have scored full marks for any eight of the following:*
- Part of £20,000/overall ISA allowance.
- Must be 18 or over;
- and under 40/make first contribution before 40;
- can contribute until/must cease at 50.
- 25% withdrawal charge unless/no withdrawals in first 12 months;
- buying first home;
- £450,000 or less;
- aged 60 or over;
- terminally ill/less than 12 months to live.
- Bonus not payable if HTB ISA bonus used.

(iii) *Candidates would have scored full marks for any four of the following:*
- Increase contribution;
- by up to £100 pm/to £200 pm.
- Stop/decrease contribution.
- Withdraw/close.
- Transfer into a LISA/ISA.
- Transfer into a different rate/provider.

(iv) *Candidates would have scored full marks for any six of the following:*
- Deceased's;
- name;
- address/proof of residency;
- NI number;
- date of birth;
- date of death;
- date of partnership.

(e) **(i)** *Candidates would have scored full marks for any eight of the following:*

OEIC

- Unlimited shares/can create new shares.
- Redeems shares linked to NAV.
- May be standalone or sub-fund of ICVC.
- Must appoint an ACD.
- Assets held by depositary.
- Can borrow on temporary basis/up to 10%.

Investment Trust

- Fixed number of shares/finite share capital.
- Shares bought/sold independent of NAV.
- Listed company.
- Has board of directors.
- Can borrow on permanent basis/unlimited.
- May have fixed life/winding up date.

(ii) **OEIC**

- Daily pricing/pricing point;
- Based upon NAV.
- Single priced;
- May apply swing pricing/dilution levy.

Investment Trust.

- Real-time pricing;
- determined by market/supply and demand.
- Dual pricing/bid/offer spread.
- Can trade at discount/premium/independent of NAV.

(f) *Candidates would have scored full marks for any six of the following:*

Advantages

- Accessible at any time/before age 55.
- No limit on contributions/not part of Annual Allowance.
- No limit on future investment value/not part of Lifetime Allowance.

Disadvantages

- No Income Tax relief.
- No employer contribution.
- Taxation within GIA/funds/subject to CGT.
- Part of estate/subject to IHT.

Model answer for Question 2

(a) *Candidates would have scored full marks for any six of the following:*

- Single point of access/all information in one place.
- Multiple tax-sheltered products.
- Less/easier administration.
- Income flexibility/consolidated payment.
- Access to planning tools/bed & ISA, etc.
- Transaction/account history.
- Migration to cheaper share classes/lower fund charges.

(b) **(i)**

- Up to 3 years;
- after/following/May 2025.
- Up to 1 year before/from now/October 2021.

(ii) *Candidates would have scored full marks for any eight of the following:*

- Existing gain;
- deferred until disposal;
- without limits/unlimited;
- can be deferred again.
- New gain;
- exempt from CGT;
- after 3 years;
- if Income Tax relief obtained.
- Loss relief available;
- offset against income or gains.

(c) Income Tax relief
£100,000 x 50% = £50,000
Carry back = £50,000

CGT reinvestment relief
£50,000 x 20% = £10,000

CGT deferral relief
£50,000 x 20% = £10,000

(d) *Candidates would have scored full marks for any four of the following:*

- **Anchoring;**
- 7% yield/£500,000 capital sum.
- **Endowment effect;**
- 'His' company/emotional attachment/retains shareholding.
- **Mental accounting;**
- Compartmentalising capital for income/used to receiving income.

(e) **(i)** *Candidates would have scored full marks for any five of the following:*

- Estimate/forecast/predict the;
- probabilistic/potential/likely;
- range of;
- returns/outcomes and;
- volatility/standard deviation.
- Under different outputs/scenarios/simulations.

(ii)

- Returns.
- Volatility/standard deviation.
- Time period.

(iii) *Candidates would have scored full marks for any four of the following:*

- Assumptions/inputs not correct/unrealistic.
- Ignores sequencing risk.
- Over-reliance/over confidence.
- Difficult to understand/too complex.
- Output is unrealistic/unattainable/expected return not accurate.
- Doesn't factor in client circumstance.

Model answer for Question 3

(a) **(i)** £18,500,000 - £2,000,000 - £4,200,000 = £12,300,000
£35,000,000 + £9,700,000 - £22,600,000 = £22,100,000
(£12,300,000 / £22,100,000) = 0.556561 x 100
= 55.66%

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

- Ability to generate;
- profit.
- How efficiently it uses;
- shareholders' funds/capital.
- Relative performance within sector/against peers.

(b) **(i)** (£3,800,000 + £2,150,000) = £5,950,000 / £1,400,000 = 4.25

(ii)
- Company in strong position.
- Can easily repay short-term/current debts from cash/most liquid assets;
- without use of other assets/external resources.

(iii) *Candidates would have scored full marks for any six of the following:*
- **Fixed/non-current assets**
- Tangible (plant, buildings etc.).
- Intangible/goodwill.
- Investments.

- **Current assets**
- Stock/inventory.
- Cash.
- Trade receivables/debtors/prepaid expenses.

(c) **(i)**
- Investments/assets.
- Loans/borrowing.
- Foreign currency reserves.

(ii)
- To finance/fund;
- a current account;
- deficit.

(iii)
- Stimulates demand/spending;
- by increasing aggregate demand.
- Increases productivity/output;
- and business investment.

(d) *Candidates would have scored full marks for any four of the following:*
- Single;
- percentage figure;
- that shows the;
- annual cost of;
- investing in/owning a fund.

All questions in the February 2022 paper will be based on English law and practice applicable in the tax year 2021/2022, unless stated otherwise and should be answered accordingly.

The Tax Tables which follow are applicable to the October 2021, February 2022 and May 2022 examinations.

INCOME TAX

RATES OF TAX	2020/2021	2021/2022
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	£37,500	£37,700
Threshold of taxable income above which additional rate applies	£150,000	£150,000

Child benefit charge:
1% of benefit per £100 of adjusted net income between £50,000 – £60,000

*Only applicable to savings income that falls within the first £5,000 of income in excess of the personal allowance

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

MAIN PERSONAL ALLOWANCES AND RELIEFS		
Income limit for Personal Allowance §	£100,000	£100,000
Personal Allowance (basic) §	£12,500	£12,570
Married/civil partners (minimum) at 10% †	£3,510	£3,530
Married/civil partners at 10% †	£9,075	£9,125
Marriage Allowance	£1,250	£1,260
Income limit for Married Couple's Allowance†	£30,200	£30,400
Rent a Room scheme – tax free income allowance	£7,500	£7,500
Blind Person's Allowance	£2,500	£2,520
Enterprise Investment Scheme relief limit on £2,000,000 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.

*** Investment above £1,000,000 must be in knowledge-intensive companies.*

Child Tax Credit (CTC)		
- Child element per child (maximum)	£2,830	£2,845
- family element	£545	£545
Threshold for tapered withdrawal of CTC	£16,385	£16,480

NATIONAL INSURANCE CONTRIBUTIONS

Class 1 Employee	**Weekly**
Lower Earnings Limit (LEL)	£120
Primary threshold	£184
Upper Earnings Limit (UEL)	£967

Total earnings £ per week	**CLASS 1 EMPLOYEE CONTRIBUTIONS**
Up to 184.00*****	Nil
184.00 – 967.00	12%
Above 967.00	2%

**This is the primary threshold below which no NI contributions are payable. However, the lower earnings limit is £120 per week. This £120 to £184 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 170.00**	Nil
170.00 – 967.00	13.8%
Excess over 967.00	N/A

*** Secondary earnings threshold.*

Class 2 (self-employed)	Flat rate per week £3.05 where profits exceed £6,515 per annum.
Class 3 (voluntary)	Flat rate per week £15.40.
Class 4 (self-employed)	9% on profits between £9,568 - £50,270. 2% on profits above £50,270.

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 & 2013/2014	£1,500,000
2014/2015 & 2015/2016	£1,250,000
2016/2017 & 2017/2018	£1,000,000
2018/2019	£1,030,000
2019/2020	£1,055,000
2020/2021 & 2021/2022	£1,073,100

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.

ANNUAL ALLOWANCE

TAX YEAR	ANNUAL ALLOWANCE
2015/2016	£40,000~
2016/2017 – 2021/2022	£40,000*

~ increased to £80,000 for pension input between 6 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.

**reducing by £1 for every £2 of 'adjusted income' over £240,000 to a minimum of £4,000 if 'threshold income' is also over £200,000.*

MONEY PURCHASE ANNUAL ALLOWANCE	2020/2021	2021/2022
	£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	2020/2021	2021/2022
Individuals, estates etc	£12,300	£12,300
Trusts generally	£6,150	£6,150
Chattels proceeds (restricted to five thirds of proceeds exceeding limit)	£6,000	£6,000

TAX RATES		
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%
Business Asset Disposal Relief* – Gains taxed at:	10%	10%
Lifetime limit	£1,000,000	£1,000,000

**For trading businesses and companies (minimum 5% employee or director shareholding) if held for at least two years.*

INHERITANCE TAX

RATES OF TAX ON TRANSFERS	2020/2021	2021/2022
Transfers made on death		
- Up to £325,000	Nil	Nil
- Excess over £325,000	40%	40%
Transfers		
- 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

	2020/2021	2021/2022
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*	£175,000	£175,000
- 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.

	2020/2021	2021/2022
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:

- Years before death	0-3	3-4	4-5	5-6	6-7
- Inheritance Tax payable	100%	80%	60%	40%	20%

Quick succession relief:

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

PRIVATE VEHICLES USED FOR WORK

	2020/2021 Rates	2021/2022 Rates
Cars		
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
Motorcycles	24p per mile	24p per mile
Bicycles	20p per mile	20p per mile

MAIN CAPITAL AND OTHER ALLOWANCES

	2020/2021	2021/2022
Plant & machinery (excluding cars) 100% annual investment allowance (first year)	£1,000,000	£1,000,000
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	6%	6%
Energy & water-efficient equipment	100%	100%
Zero emission goods vehicles (new)	100%	100%
Electric charging points	100%	100%
Qualifying flat conversions, business premises & renovations	100%	100%

Motor cars: Expenditure on or after 1 April 2016 (Corporation Tax) or 6 April 2016 (Income Tax)

CO_2 emissions of g/km:	50 or less*	51-110	111 or more
Capital allowance:	100% first year	18% reducing balance	6% reducing balance

**If new*

MAIN SOCIAL SECURITY BENEFITS

		2020/2021	2021/2022
		£	£
Child Benefit	First child	21.05	21.15
	Subsequent children	13.95	14.00
	Guardian's allowance	17.90	18.00
Employment and Support Allowance	Assessment Phase		
	Age 16 - 24	Up to 58.90	Up to £59.20
	Aged 25 or over	Up to 74.35	Up to £74.70
	Main Phase		
	Work Related Activity Group	Up to 74.35	Up to 104.40
	Support Group	Up to 113.55	Up to 114.10
Attendance Allowance	Lower rate	59.70	60.00
	Higher rate	89.15	89.60
Basic State Pension	Single	134.25	137.60
	Married	268.50	275.20
New State Pension	Single	175.20	179.60
Pension Credit	Single person standard minimum guarantee	173.75	177.10
	Married couple standard minimum guarantee	265.20	270.30
	Maximum savings ignored in calculating income	10,000.00	10,000.00
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
Jobseeker's Allowance	Age 18 - 24	58.90	59.20
	Age 25 or over	74.35	74.70
Statutory Maternity, Paternity and Adoption Pay		151.20	151.97

CORPORATION TAX

	2020/2021	2021/2022
Standard rate	19%	19%

VALUE ADDED TAX

	2020/2021	2021/2022
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 - £925,000	5%
£925,001 - £1,500,000	10%
£1,500,001 and over	12%

Important note regarding Stamp Duty Land Tax (SDLT) and residential property purchases:

- **For purchases between 1 July 2021 and 30 September 2021, SDLT does not apply up to £250,000.**
- **For purchases above £250,000, the band rates above apply as normal.**
- **For purchases from 1 October 2021, the band rates above apply as normal.**

Additional SDLT rules still apply as below.

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 may be 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.

	Non residential
Value up to £150,000	0%
£150,001 and £250,000	2%
£250,001 and over	5%