Chartered Insurance Institute

AF4

Advanced Diploma in Financial Planning

Unit AF4 – Investment Planning

February 2022 Examination Guide

SPECIAL NOTICES

Candidates entered for the May 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

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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 performed well in this paper, exceeding the level of performance seen in the previous session. The composition of the paper included a diverse range of syllabus areas based upon core content, areas tested frequently, complemented by peripheral content and those tested less frequently. This offered well-prepared candidates the opportunity to perform to a pass standard, while offering better-prepared candidates the capability to excel.

Across the calculation questions, the majority of candidates showed all the relevant workings and those who did not perform well either used incorrect values within the correct formula or used the incorrect formula.

In non-calculation questions, candidates who did not perform well displayed two common behaviours: firstly, a proclivity for repetition of the same point(s) several times either within the same question-part or within different question-parts of a question, in effect duplicating their answer to part (i) in part (ii).

Secondly, in questions relating to investment risks and behavioural finance, the regurgitation of model answers from previous Examination Guides, for example the same long list of investment risks or behaviours. It is important that candidates read the question being asked carefully and ensure their answer is aligned with the requirements of the question, as answers containing vague or generic answers are unlikely to be awarded many of the available marks.

It was pleasing to see fewer candidates writing expansive, narrative-style answers, usually written in the belief that the more they wrote, the more marks would be awarded, in favour of more candidates answering with a succinct, bullet-point focused style. This produces more effective exam technique and in general results in more marks being awarded.

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

Question 1

In part (a) candidates performed very well with the majority gaining all the available marks in part (a)(i). In part (a)(ii), most candidates identified at least half of the available marks, with better candidates also being awarded the mark for stating valid reasons for a 'one-off increase in earnings'.

In part (b) candidates performed well, with most candidates who used the correct formula achieved maximum marks. Those candidates who did not perform either used the incorrect formula or did not show all the stages of their calculation.

In part (c) candidates performed very well. In part (c)(i), almost all candidates were awarded maximum marks. Those candidates who did not achieve the maximum marks available usually only stated three strategies, where the question had asked for four. In part (c)(ii), candidates performed adequately. A high proportion of candidates simply stated a list of risks and reasons that were generic rather than specific to the question-part. This list was often a mixture of similar model answers from previous Examination Guides, setting out various general investment risks, many of which did not relate to the case study and so did not answer the question being asked.

In part (d) candidates performed adequately. In part (d)(i) the majority of candidates identified at least one method of index weighting. In part (d)(ii) the majority of candidates gained at least two out of the four marks available. In part (d)(iii) candidates did not perform well although this was the first time this area of the syllabus was tested. It was pleasing to see a reasonable proportion of candidates identified two of the four marks available.

In part (e) candidates performed very well with almost all candidates achieving a high number of the marks available, with a significant proportion being awarded maximum marks. This question-part brought together three measures that would normally be tested separately so it was pleasing to see candidates were able to connect them and apply their respective, distinct purposes.

In part (f) candidates performed adequately. A notable proportion of candidates attempted to calculate rather than state the levels of FSCS protection. Most candidates identified the correct investment limit and that direct equities were not covered. Candidates who did not perform well either stated an incorrect investment limit, with some stating £50,000 and in a few instances even £48,000 (the latter being more than a decade out-of-date), and/or that the investment and pension limits – for a pension provider not a SIPP operator – are the same. As FSCS limits are tested at Certificate and Diploma levels, it is perhaps surprising to see the relatively poor level of existing knowledge at Advanced Diploma level.

In part (g) candidates performed well. In part (g)(i) the majority of candidates gained four or all five marks available. In part (g)(ii) most candidates achieved in the upper half of the available marks, performing better than the previous occasion when this syllabus area was tested for the first time. It was pleasing to see a significant proportion of candidates analysed the case study and were awarded the marks for 'reduce equity/market/volatility risk', 'invest in fixed interest/diversification across asset classes' and for 'increase cash/hold sufficient level of cash/take withdrawals from cash'.

In part (h) candidates performed very well. Those candidates who did not perform well used incorrect variables in their calculations. A reasonable proportion of candidates rounded up the SDRT figure, which would be correct for SD only, perhaps in the belief that as their answer at two decimal places included pence, the next mark had to be to round up. The majority of candidates who stated a figure for the PTM levy were correct although a reasonable number of candidates were out by a factor of 10 and even 100, both for the SDRT and PTM figures. As a consequence, these candidates offered total SDRT/PTM figures ranging from £584 to £5,933, the latter being more than one half of the purchase cost of the shares. However, overall performance on this question-part showed a notable improvement compared to the previous occasion it was tested.

Question 2

In part (a) candidates performed adequately. Both question-parts were tested for the first time, so it was pleasing to see a good proportion of candidates achieving in the upper half of the marks available across both question-parts. In part (a)(i) candidates who did not perform well generally stated generic due diligence factors relating to platform selection – perhaps based upon this being the model answer to previous question-parts on platforms – and in part (a)(ii), then duplicated their answers from part (a)(i). However, those candidates who performed well used the case study to extract and identify marks in both parts (a)(i) and (a)(ii).

In part (b) candidates performed very well. The majority of candidates were awarded the maximum marks available in parts (b)(i) and part (b)(ii). In part (b)(i) the only mark that was generally not awarded was where candidates stated 'ISA income totally tax-free' and did not break this down by the equities and fixed interest components. In part (b)(ii) a reasonable proportion of candidates did not include the DA and PSA in their calculation, despite having stating these in their answer to part (b)(i). A small number of candidates incorrectly applied HRT to their calculations.

In part (c) candidates performed adequately. In part (c)(i) the majority of candidates gained around or in the upper half of the marks available. It was pleasing to see an increasing number of candidates identify 'Accessibility' and 'Liquidity' as separate risks, even if their outline of each was often the wrong way around. In part (c)(ii) most candidates achieved one or two marks out of those available with a small number of candidates achieving maximum marks.

In part (d) candidates performed well. In part (d)(i) almost all candidates gained four or all five marks available, demonstrating widespread knowledge of this definition. In part (d)(ii) most candidates gained at least one of the three marks available, which was pleasing at this syllabus area was tested for the first time.

Question 3

Overall candidates performed well in part (a). In part (a)(i) the majority of candidates gained three marks and only did not gain all the marks available due to not showing the output of the first subtraction, in effect jumping a stage in their answer. In part (a)(ii) most candidates gained at least one mark with better-prepared candidates being awarded the 'similar return could have been achieved through passive/active management not worth the cost' mark.

In part (b) candidates performed adequately. Part (b)(i) was tested for the first time and as a consequence was a relative generic introduction to MPS. Many candidates explained the differences between advisory and discretionary management, often repeating content contained in the case study. A number of candidates also stated an MPS to be the same as a DIM arrangement. In part (b)(ii) the majority of candidates achieved around or in the upper half of the six marks available. Candidates who did not perform well listed general client factors that would be gathered at the fact-finding stage and were not specific to the evaluation of a DIM service.

In part (c) candidates performed very well, with almost all candidates identifying the economic cycle in the correct sequence. Those candidates who did not perform well either put the stages out of sequence or stated incorrect stages, using unrelated economic terms.

In part (d) candidates performed adequately. Candidate knowledge of macro-economics and the relevant syllabus areas is consistently poor, although part (d) was divided into three sub-question parts to offer greater opportunity for candidates to be awarded more marks. In part (d)(i) most candidates knew the main difference between the definitions. In part (d)(ii) the majority of candidates identified the correct measure and had a basic awareness of why it is the better indicator. In part (d)(iii) the majority of candidates identified 'increase interest rates' although a proportion got this point the wrong way around. In addition, perhaps as a result of recent actions by the Bank of England MPC, a good proportion of candidates were awarded the marks for QE and/or QT.

In part (e) candidates performed well. This is the second time this area has been tested and it was pleasing to see there was notable improvement over the previous occasion, with a small number of candidates being awarded nearly all of the marks available. Most candidates either identified two of the main types or two of the main purposes, although often a purpose did not match the correct type.

In part (f) candidates performed well. The majority of candidates gained in the upper half of the marks available and a good proportion of candidates achieved all of the available marks. Those candidates who performed well connected the reason to information contained in the case study. Those who did not perform well listed multiple biases with reasons that were unrelated to the case study.

Chartered Insurance Institute

AF4

Advanced Diploma in Financial Planning

Unit AF4 – Investment planning

February 2022 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), (f), (g) and (h) which follow.

Edward, aged 61, is a self-employed consultant in the energy sector. Over the past decade, his net profits have averaged £75,000 per annum but this figure has reduced significantly over the past two years.

Edward had originally planned to stop working at age 70. However, he would now like to discuss ways of generating an income stream from his portfolio sooner than planned. Edward is considering an income stream of £48,000 per annum for the next two years to subsidise his consultancy earnings. At the end of this period, he believes his net profit will return to its previous average.

Edward has two personal pensions with a combined current value of £390,000. He does not currently make any contributions and has not taken any benefits from the plans. Edward also has an investment portfolio with a current value of £490,000. The portfolio consists of a wide range of equity-based Exchange Traded Funds (ETFs), as set out in **Table 1** below.

Table 1

Provider	Country	Index	Current value
XYZ Passives	UK	FTSE 100	£80,000
XYZ Passives	UK	FTSE All-Share	£110,000
3W Funds	North America	S&P 500	£103,000
Longview	North America	NASDAQ	£140,000
Simple Indices	Japan	MSCI Japan Small Cap	£57,000

In addition, Edward has accumulated shares in a UK-listed oil and gas exploration company, Submersh plc, details of which are set out in **Table 2** below.

Table 2

Number of shares owned	Current share price	Earning after taxation	Dividend per share	Number of shares in issue
18,000	448p	£35,400,000	16.2p	28,000,000

The sector average price earnings ratio for Submersh plc is 9.8.

The Submersh plc shares are held via a platform. For the past four years, Edward has allowed the dividends to accumulate in the platform's cash account which pays no interest.

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 price earnings (P/E) ratio for Submersh plc. **(5)**

(ii) Compare the P/E ratio of Submersh plc, based upon your answer to **part (a)(i)** above, to its sector average and explain briefly the possible reasons for the difference. **(4)**

(b) **(i)** Calculate, **showing all your workings**, the dividend cover for Submersh plc. **(4)**

(ii) Comment briefly on what can be deduced from the dividend cover figure based upon your answer to **part (b)(i)** above. **(3)**

(c) **(i)** State the **four** main types of index replication strategy and describe briefly how each strategy works. **(8)**

(ii) Identify **five** specific investment risks to which Edward may be exposed within his investment portfolio and state **one** reason for **each** risk. **(10)**

(d) **(i)** State the **three** main ways in which a stock market index is weighted. **(3)**

(ii) Identify **four** events that can cause a constituent company to enter or leave the FTSE 100 at a periodic rebalancing. **(4)**

(iii) Explain briefly what is meant by ‘free float’ and how it affects a company’s weighting in FTSE UK indices. **(4)**

(e) State **three** main metrics that would be used to measure the risk-adjusted return of an actively-managed fund and outline **two** distinct purposes of **each** metric. **(9)**

(f) State the **maximum** Financial Services Compensation Scheme (FSCS) compensation limits that would apply to Edward’s pension and investment assets. *Exclude the money accumulated within the cash account from your answer.* **(8)**

(g) **(i)** State the options that are open to Edward in respect of generating the income stream that he is considering from his personal pensions. *Assume that the provider(s) offers all of the available options*. **(5)**

(ii) Describe the actions that Edward could take to mitigate the effects of sequencing risk, if he were to consider drawing the income stream from his overall portfolio over the medium to long term. **(7)**

(h) Calculate, **showing all your workings**, the Stamp Duty Reserve Tax and any levy that Edward would pay if he used the cash from the accumulated dividends to purchase more shares in Submersh plc. *Assume that the number of shares owned by Edward and the dividend per share have remained unchanged for the past four years.* **(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) and (d) which follow.

Magda is an investment adviser within an authorised advisory firm. She is reviewing the portfolio of a retail client who has recently been taken on by the firm. The client's only income is a salary of £35,000 per annum and their primary objective is to generate a high level of additional income from their capital assets.

The client has asked Magda to research seemingly high-yielding alternative investments, such as peer-to-peer lending and student accommodation. While the client has stated that they have an adventurous attitude to risk, Magda believes that the client may not appreciate the difference between attitude to risk and capacity for loss.

Currently the client is invested in a range of directly-held UK equity income and strategic bond collective funds. These funds are held on a platform, within a general investment account (GIA) and a stocks and shares ISA, as per **Table 1** below.

Table 1

Wrapper	Asset class	Current value	Current yield
ISA	Equity income	£70,000	2.1%
ISA	Fixed interest	£165,000	3.5%
GIA	Equity income	£110,000	2.1%
GIA	Fixed interest	£95,000	3.5%

The platform on which the client's assets are held has recently communicated that it plans a significant technology upgrade that will mean migrating the platform to a new technology provider.

Questions

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

(a) **(i)** State **four** areas that the advisory firm would need to consider, in respect of the potential impact of the platform's change in technology provider on **the advisory firm**. **(4)**

(ii) State **four** main risks to **the client** that could arise during the migration process. **(4)**

(b) **(i)** State the tax treatment of the income generated from the funds held in the GIA and ISA, based upon the client's tax position. **(9)**

(ii) Calculate, **showing all your workings**, how much of the income generated by the overall portfolio is subject to the client's personal taxation. **(6)**

(c) **(i)** Identify **three** main risks to which the client would be exposed if they invested in high income alternative investments and outline **each** risk. **(6)**

(ii) Identify **three** factors that could impact on the potential to hold alternative assets on a platform. **(3)**

(d) **(i)** Describe briefly what is meant by the term 'capacity for loss'. **(5)**

(ii) Outline **three** ways in which the effects of capacity for loss can be mitigated. **(3)**

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

Abeo, a retail client, is about to have a review meeting with his financial adviser, Priya. In advance of the meeting, Priya has communicated that her firm is about to expand its discretionary investment management (DIM) service by offering its recently-launched, managed portfolio service (MPS) to a wider range of its clients.

The MPS is actively managed by the firm's investment committee and invests across a range of equity markets. The service is now a little over twelve months old and the annual performance data of one of its portfolios is set out in **Table 1** below.

Table 1

Risk III fund return	Benchmark return	Tracking error	Risk-free return
10.7%	10.4%	1.65%	0.15%

One of the objectives of the review meeting is to discuss whether Abeo should consider moving some of his current investment portfolio onto the MPS.

Abeo would like to discuss a potential investment that he saw online. The investment offers a 9% per annum fixed yield but makes little reference to capital. He says that his own research into investments has been successful in the past and he believes this particular one can deliver the stated income. In a previous conversation, Priya has outlined that the investment is highly sensitive to the economic cycle in general and money supply in particular. Abeo has said that he would like to understand more about these factors.

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 information ratio for Risk III fund. **(4)**

(ii) Comment on what can be deduced about Risk III fund's performance based upon the information ratio figure from your answer to **part (a)(i)** above. **(2)**

(b) **(i)** Describe briefly the main features of an MPS. **(5)**

(ii) Identify **six** main factors that Priya would take into consideration when evaluating a DIM service for Abeo. **(6)**

(c) Identify the main phases of the economic cycle, **in the order that they occur**, starting with the recession phase. **(4)**

(d) **(i)** State the **main** difference between the definitions of the M0 and M4 measures of money supply. **(3)**

(ii) Identify which money supply measure best indicates overall economic growth and state **two** reasons why. **(3)**

(iii) Explain briefly the likely monetary policy response to a sustained increase in money supply in the UK economy. **(3)**

(e) State the **three** main types of benchmark and describe briefly the purpose of **each** type. **(6)**

(f) From a behavioural finance perspective, identify **two** biases that relate to Abeo's view of the potential online investment and state **one** reason to explain each bias. **(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)** £35,400,000 / £28,000,000 = 1.264285 = 126.43p
448p / 126.43p = 3.54

(ii)
- P/E is lower.
- Undervalued/out of favour.
- Bad management/decline in business.
- Event causing a one-off increase in earnings.

(b) **(i)** 16.2p x £28,000,000 = £4,536,000
£35,400,000 / £4,536,000 = 7.804232 = 7.8

Alternative
£35,4000,000 / £28,000,000 = 1.264285 = 126.43p
126.43p / 16.2p = 7.8

(ii) *Candidates would have scored full marks for any three of the following:*
- High coverage/dividend well-covered.
- Retaining majority of profits.
- Company financially stable/dividend secure/sustainable.
- Low growth/ex-growth business.

(c) **(i)**
- **Physical/Full Replication**
- Buys all stocks within index in correct weighting.
- **Stratified/Simplified Sampling**
- Buys subset/selection/sample of stocks within index.
- **Optimisation**
- Buys computerised model of index.
- **Synthetic**
- Uses derivatives/swaps.

(ii) *Candidates would have scored full marks for any ten of the following:*
- **Currency**
- Exposed to Dollar/Yen/exchange rate movement.
- **Concentration/Overlap**
- Composition/market weighting of index/duplication/same stocks held in more than one fund.
- **Market/Volatility**
- NASDAQ/Japan Small Cap/beta likely to be greater than 1.
- **Counterparty**
- Failure of ETF.
- **Passive/Product**
- Replication style causes underperformance/underperforms index.

(d) **(i)**
- Value/market capitalisation.
- Price.
- Equal/unweighted.

(ii)
- New listing/IPO.
- Delisting/switch to another market/becomes ineligible.
- Merger/acquisition/takeover.
- Change in share price/market cap.

(iii)
- Proportion/percentage of shares;
- traded on market.
- Companies with less than minimum free float;
- have weighting reduced.

(e)
- **Alpha**
- Stock-picking/value added by manager.
- Excess return not explained by beta.
- **Sharpe**
- Excess return for every unit of risk/risk-free rate.
- Excess return over standard deviation.
- **Information Ratio**
- Consistency of manager.
- Excess return over benchmark.

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

Investment;
- £85,000;
- per firm.
- Shares;
- no protection.

Pension;
- 100%;
- without limit.
- per provider.
- SIPP;
- £85,000;
- per operator/firm.

(g) **(i)**
- Drawdown/FAD.
- PCLS only.
- UFPLS.
- Phased retirement.
- Buy short-term/fixed term annuity.

(ii) *Candidates would have scored full marks for any seven of the following:*
- Reduce the level of initial withdrawal.
- Change the timing/frequency of withdrawals.
- Stick to his original retirement plan/date.
- Alter asset allocation/reduce equity/market/volatility risk.
- Invest in fixed interest/diversification across asset classes.
- Increase cash/hold sufficient level of cash/take withdrawals from cash.
- Take natural income/dividends.
- Secure income through annuity.

(h) **SDRT**

16.2p x 18,000 x 4 = £11,664

£11,664 x 0.5% = £58.32

PTM levy

£1

Total = £59.32

Model answer for Question 2

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

- Ownership of technology provider/conflict of interest/financial stability of tech provider.
- Ability to meet existing clients' needs/expectations.
- Timescale for upgrade/testing/phasing of migration.
- Business continuity plan during upgrade/reliance on sole platform.
- Front/back office compatibility/loss of functionality/tools/reporting.
- Impact on firm's advice proposition/reputation.
- Time/cost to firm.

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

- Loss of service/outage/access.
- Loss of income payments.
- Unable to trade/buy/sell/out of market.
- Data breach/loss.
- Loss of transaction history/legacy data.
- Increase in costs.

(b) **(i)** **ISA**

- Dividends;
- and interest/distributions;
- free of personal taxation/not subject to Income Tax.

GIA

- Dividends;
- taxed at 7.5%;
- once DA/£2,000 used.
- Interest/Distributions;
- taxed at 20%;
- once PSA/£1,000 used.

(ii) **GIA**

£110,000 x 2.1% = £2,310
less £2,000 = £310.
£95,000 x 3.5% = £3,325
less £1,000 = £2,325.

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

- **Income**
- May be unsustainable/cut/not paid.
- **Unregulated**
- Not subject to FSCS/investor protection.
- **Accessibility**
- Unable to sell underlying assets.
- **Liquidity**
- Wide price spread/hard to sell.
- **Capital loss/Valuation**
- Assets may be written down/down-valued.
- **Correlation**
- May not be uncorrelated/may be more correlated with equities.
- **Interest rate/Gearing**
- Sensitive to interest rate rises/cyclical.

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

- Asset may not be eligible/not available to retail clients.
- Dealing infrequent/not readily realisable/unable to sell.
- Additional costs of ownership.
- May require third party to transact/may have to trade manually.
- Valuation/price may not show automatically/may have to input manually.

(d) (i)

- The ability;
- to absorb;
- any negative investment event;
- without an adverse/detrimental effect;
- on lifestyle/standard of living.

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

- Reduce portfolio risk/AtR.
- Hold sufficient cash to cover potential loss/event.
- Invest less/only invest what client can afford to lose.
- Discuss and agree CfL with client in advance.
- Establish the actual risk the client is willing to take/not focus on the outcome.
- Avoid overreliance on tools/simplified questions/inappropriate assessment of information.

Model answer for Question 3

(a) **(i)** 10.7 - 10.4 = 0.3
0.3 / 1.65 = 0.181818 = 0.18

(ii) *Candidates would have scored full marks for any two of the following:*
- Value added by manager/outperformance.
- Low risk-adjusted return/information ratio.
- Similar return could have been achieved through passive/tracker fund/active management not worth the cost.

(b) **(i)** *Candidates would have scored full marks for any five of the following:*
- Collectives-based.
- Low minimum investment.
- Asset allocation/fund selection determined centrally/by external manager/investment committee.
- Portfolio changes can result in client CGT liability.
- Range of risk-adjusted portfolios.
- Portfolios not bespoke to client/limited choice.
- Low cost.

(ii) *Candidates would have scored full marks for any six of the following:*
- Charges.
- Overlap with existing/non-DIM assets.
- Regulatory permissions/reputation/financial strength.
- Past performance/track record.
- Investment style/strategy.
- Client's AtR/use of unsuitable/high risk assets.
- Conflict of interest.
- Basis of agreement.
- Ownership of client.

(c)
- Recovery.
- Boom/expansion.
- Contraction.
- [Correct order of phases].

(d) **(i)**
- M0 excludes/M4 includes;
- bank/building society accounts;
- of UK residents.

(ii)
- M4.

Candidates would have scored full marks for any two of the following:
- Broader/wider scope.
- Reflects borrowing/lending.
- Reflects velocity/transfer of money.

(iii) *Candidates would have scored full marks for any three of the following:*
- Reduce/cease;
- QE.
- Sell bonds back to market/QT.
- Increase interest rates.

(e)
- **Target**;
- measure/calculate performance/fee.
- **Comparator**;
- comparison of performance.
- **Constraint**;
- limit portfolio construction/asset allocation.

(f) *Candidates would have scored full marks for any four of the following:*
- **Anchoring;**
- fixated on 9%.
- **Overconfidence;**
- believes own research is best/overreliance on own knowledge.
- **Misunderstanding Of Probability;**
- too focused on yield at expense of potential risk to capital.

Glossary of terms

Some abbreviations candidates can you use in financial planning online exams:

1. AA – Annual allowance
2. ACD – Authorised capital director
3. AER – Annual equivalent rate
4. AMC – Annual management charge
5. APR – Annual percentage rate
6. APS – Additional permitted subscription
7. ART – Additional-rate tax
8. AtR – Attitude to risk
9. BRT – Basic-rate tax
10. CAPM – Capital Asset Pricing Model
11. CDS – Credit default swap
12. CfL – Capacity for loss
13. CGT – Capital Gains Tax
14. CPI – Consumer Prices Index
15. CTF – Child trust fund
16. DA – Dividend allowance (only added as PSA is already included)
17. DB – Defined benefit
18. DC – Defined contribution
19. DCF – Discounted cash flow
20. D/E – Debt-to-equity
21. DJIA – Dow Jones Industrial Average
22. DIM – Discretionary investment management
23. DFM – Discretionary fund manager
24. EBIT/EBITDA – Earnings before interest and tax/depreciation and amortisation
25. EIS – Enterprise investment scheme
26. EMH – Efficient market hypothesis
27. ESG – Environmental, social and governance
28. ETC – Exchange traded commodity
29. ETF – Exchange traded fund
30. ETN – Exchange traded note
31. ETP – Exchange traded product
32. EPS – Earnings per share
33. FAD – Flexi-access drawdown
34. FCA – Financial Conduct Authority
35. FoF – Fund of funds
36. FOS – Financial Ombudsman Service
37. FSCS – Financial Services Compensation Scheme
38. FTSE – Financial Times Stock Exchange
39. GAARP – Growth at a reasonable price
40. GDP – Gross domestic product
41. GIA – General investment account
42. HRT – Higher-rate tax
43. HTBISA – Help to Buy individual savings account
44. IA – Investment Association
45. ICVC – Investment company with variable capital
46. IHT – Inheritance Tax

47. ISA – Individual savings account
48. IPO – initial public offering
49. IFISA – Innovative finance individual savings account
50. IT – Income Tax caution as IT is more widely-used in AF4 as abbreviation of investment trust
51. JISA – Junior individual savings account
52. LCF – Lifetime cash flow
53. LISA – Lifetime individual savings account
54. LTA – Lifetime allowance
55. MPC – Monetary Policy Committee
56. MPT – Modern portfolio theory
57. MSCI – Morgan Stanley Capital International
58. MVR – market value reduction
59. MPS – Model portfolio service
60. MSCI – Morgan Stanley Capital International
61. MVR – Market value reduction
62. MWR – Money-weighted rate of return
63. NASDAQ – National Association of Securities Dealers Automated Quotations
64. NAV – Net asset value
65. NICs – National Insurance contributions
66. NPA – Normal pension age
67. NRA – Normal retirement age
68. NRB – Nil rate band
69. NS&I – National Savings and Investments
70. OCF – Ongoing charges figure
71. OEIC – Open-ended investment company
72. OPA – Ordinary power of attorney
73. OEIC – open ended investment company
74. P/B – Price-to-book
75. P/E – Price-earnings/price-to-earnings
76. PAIF – Property authorised investment fund
77. PAYE – Pay As you Earn
78. PET – Potentially exempt transfer
79. PIA – Property Income Allowance
80. PID – Property income distribution
81. PPP – Personal pension plan
82. PCLS – Pension commencement lump sum
83. PRA – Prudential Regulation Authority
84. PA – Personal Allowance
85. PSA – Personal Savings Allowance
86. PTM – Panel of Takeovers and Mergers
87. QE – Quantitative easing
88. QT – Quantitative tightening
89. REIT – Real estate investment trust
90. ROCE – Return on capital employed
91. ROE – Return on equity
92. RPI – Retail Prices Index
93. S&P – Standard and Poor’s
94. SICAV - Société d'investissement à capital variable
95. SD – Stamp Duty

96. SDLT – Stamp Duty Land Tax [LTT (Wales) and LBTT (Scotland) not included as we don't test them]
97. SDRT – Stamp Duty Reserve Tax
98. SIPP – Self-invested personal pension plan
99. SEIS – Seed enterprise investment scheme
100. SRI – Socially responsible investing
101. TER – Total expense ratio
102. TWR – Time-weighted rate of return
103. UCITS – Undertakings for collective investment in transferable securities
104. UCIS – Unregulated collective investment scheme
105. UFPLS – Uncrystallised fund pension lump sum
106. VCT – Venture capital trust

All questions in the May 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%