



Chartered
Insurance
Institute

AF4

Advanced Diploma in Financial Planning

Unit AF4 – Investment planning

October 2023 examination

SPECIAL NOTICES

All questions in this paper are based on English law and practice applicable in the tax year 2023/2024, 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.

Mitchell, aged 35, is employed as the managing director of a plant hire company, Sauropod Plant Ltd. His salary is £55,000 per annum. The business is majority owned by Mitchell's parents and he has worked in the business since leaving school.

Five years ago, Mitchell was gifted an initial shareholding and as a result has been receiving annual dividends. Sauropod Plant Ltd's draft accounts for the most recent year indicate that Mitchell is likely to receive a dividend of at least £80,000. Mitchell expects his shareholding to increase over the coming years although his parents have said they plan to sell their interest via a trade sale when they retire, rather than pass the business in full to Mitchell. Mitchell has approached his parent's financial adviser, Gabriella, with a view to becoming a new client to discuss investment planning as he can no longer rely upon inheriting the business in its entirety.

Over the past five years, Mitchell has invested each year's dividend to fully fund a stock and shares ISA with the excess purchasing shares in a private limited company, Stratosphere Scaffolding Ltd, which is majority owned by one of his friends, Karolek. The ISA holds shares in a FTSE 100 listed housebuilder.

The recent annual returns from this company are set out in Table 1 below:

Table 1

	2021	2022
FTSE 100 listed housebuilder	17.5%	-41.3%

Karolek has told Mitchell that Stratosphere Scaffolding Ltd has a return on equity (ROE) that is better than the return from FTSE 100 Index and therefore it must be a good investment. Several of their mutual friends have also invested in the company.

Financial information for Stratosphere Scaffolding Ltd is set out in Table 2 below:

Table 2

	Year to 31 st December
Operating profit	£1,700,800
Interest paid	£380,000
Tax paid	£279,000
Share capital	£4,000,000
Reserves	£160,000
Retained earnings	£95,000

Gabriella has pointed out to Mitchell that his existing investments are exposed to some distinct risks and that he should consider diversification for the investment of future dividends. Mitchell believes that, as his portfolio has done well over the medium term, it will continue to do so in the future. He has also mentioned that he keeps reading about money supply and inflation figures increasing, which Mitchell is sure are positive signs for investing.

Gabriella has also raised the importance of defining Mitchell's attitude to risk and capacity for loss, as Mitchell has previously decided upon his own investments with little research or investment process.

In a recent conversation, Karolek mentioned that Stratosphere Scaffolding Ltd is considering using an Enterprise Investment Scheme (EIS) to raise capital to fund its growth and suggested that Mitchell speak with his financial adviser. Mitchell is interested in how an EIS could form part of his future investment strategy.

Questions

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

- (a) (i) Explain briefly the aim of Modern Portfolio Theory (MPT) and how it is achieved. (5)
- (ii) State the key assumptions upon which MPT is based. (5)
- (iii) Explain briefly to Mitchell **four** main benefits of diversification within an investment portfolio. (4)

- (b) (i) Describe briefly what is measured by standard deviation. (4)
- (ii) Calculate, **showing all your workings**, the standard deviation of the FTSE 100 listed housebuilder using the returns data for the previous two years. (9)

- (c) Identify **six** main risks relating to Mitchell's existing investments and give **one** reason for **each** risk. (12)

- (d) (i) Outline the main differences between the Consumer Prices Index (CPI) and Retail Prices Index (RPI) measures of UK inflation. (5)
- (ii) Describe briefly the main differences between broad and narrow money. (4)
- (iii) Identify the likely economic consequences of a sustained increase in the UK money supply. (3)

QUESTIONS CONTINUE OVER THE PAGE

- (e) (i) Calculate, **showing all your workings**, the return on equity (ROE) for Stratosphere Scaffolding Ltd. (9)
- (ii) State **three** drawbacks that Mitchell should consider when using ROE as a measure of a company's performance. (3)
- (f) (i) State **five** non-financial factors that could influence Mitchell's attitude to risk. (5)
- (ii) State **four** ways in which capacity for loss can be mitigated. (4)
- (g) Identify the **two** investor biases that Mitchell is exhibiting and give the reason why for **each** bias. (4)
- (h) State **four** ways in which an Enterprise Investment Scheme (EIS) could provide Mitchell with greater tax planning opportunities compared to his stocks and shares ISA. (4)

Total marks available for this question: (80)

Section B questions can be found on pages 8 – 11

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

Matea is an investment adviser within an authorised advisory firm. She is currently reviewing the investment portfolio of Patrick, who is a retail client of the firm and in his mid-60s. For the past 30 years Patrick's main objective has been capital accumulation and his portfolio has been focused solely upon capital growth.

The portfolio is valued at approximately £275,000 and is held within a general investment account (GIA) on a platform. The GIA is invested solely in Strategic Long View plc, a FTSE 250 listed investment trust that invests in listed and unlisted smaller companies. The investment trust has recently moved to a 40% discount.

Recent financial details of the investment trust are set out in Table 1 below:

Table 1

Share price return	Market return	Beta	Tracking error	Risk-free return
-4.7%	7.2%	1.3	5.8%	2.9%

In the most recent annual report from Strategic Long View plc, the fund's manager explains that the recent performance has been affected by the trust not switching from strategic to tactical asset allocation, as well as its level of gearing. Matea has also noticed two significant institutional investors have announced their intention to sell down their shareholdings in the near future.

As a result of a health condition, Patrick intends to retire partially within the next 6-12 months with a view to retiring fully within the subsequent 3-4 years. Upon retirement, Patrick will have an income need and would like to start drawing a monthly income from his portfolio for the first time. This need will increase in due course with his full retirement, whereupon he will need an income over the medium to long term.

In a previous review meeting, Matea outlined sequencing risk. As Patrick's portfolio is now approaching the decumulation phase, he has asked Matea to explain ways in which this risk can be mitigated.

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 Strategic Long View plc. (6)
- (ii) Comment on what can be deduced about the performance based upon the alpha figure from your answer to **part (a)(i)** above. (4)
- (b) (i) Describe briefly the objective of gearing within an investment trust. (3)
- (ii) Explain briefly the possible consequences that could result from an investment trust increasing its level of gearing. (4)
- (c) (i) Describe briefly what is meant by an investment trust trading at a discount. (3)
- (ii) Identify **five** possible reasons for the current level of discount at which Strategic Long View plc is trading. (5)
- (d) Identify the **three** main income options that could be available on the platform's cash account to support Patrick in meeting his income need. (3)
- (e) Explain briefly to Patrick how tactical asset allocation differs from strategic asset allocation. (4)
- (f) (i) State **three** client-related factors that could impact upon Patrick's income requirement in retirement. *Exclude attitude to risk and capacity for loss from your answer.* (3)
- (ii) Describe **five** actions that Patrick could take to mitigate the effects of sequencing risk. (5)

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

Tommaso has just become a new retail client of an authorised advisory firm of independent financial advisers. Until recently he has managed his own investments on a direct-to-consumer platform, but Tommaso now feels that his needs can be better met by receiving financial advice.

Tommaso has an investment portfolio with a current value of £425,000 that is invested in two conventional gilts on a direct basis as well as a collective fund that sits in the Investment Association UK Gilts sector. Tommaso originally invested £90,000 into each direct gilt and £100,000 into the collective fund.

Details of the direct gilts are set out in Table 1 below:

Table 1

Gilt	Purchase price	Current clean price	Years to redemption	Half-yearly coupon
X	£147.28	£116.32	14	£1.85
Y	£92.76	£96.17	3	£2.20

As a result of the price fluctuations in gilt markets over recent months, Tommaso is considering whether to sell one or both of the gilts and reinvest the proceeds into the collective fund. He has asked his financial adviser to review his fixed interest holdings with particular reference to the outlook for gilts in the short-term as well as the security of his capital.

In researching the collective fund, the adviser has noted that there is an allocation within the fund to index-linked gilts that appears to have been a source of notable underperformance in recent months despite inflation having increased significantly over the same period.

In addition, the most recent fund commentary talks about altering the fund's duration as a response to expected quantitative tightening (QT) and a change in the yield curve.

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 redemption yield for Gilt X. *Ensure you use the simplified method in your answer.* (7)
- (ii) Compare the characteristics of Gilts X and Y as shown in **Table 1** and explain what can be deduced from this information. (6)
- (b) (i) State **three main benefits** of owning a gilt-based collective fund compared to owning Gilts X and Y on a direct basis. (3)
- (ii) State **three main drawbacks** of owning a gilt-based collective fund compared to owning Gilts X and Y on a direct basis. (3)
- (c) Identify **three** reasons why index-linked gilt prices would fall when inflation itself is rising. (3)
- (d) (i) Outline the effects of increases in interest rates on conventional fixed interest securities. (4)
- (ii) State the main objectives of quantitative tightening (QT). (3)
- (iii) Explain briefly to Tommaso the consequences of a central bank implementing QT. (3)
- (iv) Identify **four** main factors that would cause the UK yield curve to steepen. (4)
- (e) Comment on the investor protection when investing in gilts and state, giving your reasons why, whether all of Tommaso's portfolio is protected. *No calculations are required in your answer.* (4)

Total marks available for this question: 40

The tax tables can be found on pages 13 – 19

INCOME TAX

RATES OF TAX	2022/2023	2023/2024
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	£37,700	£37,700
Threshold of taxable income above which additional rate applies	£150,000	£125,140
High income 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.*

Personal savings allowance (for savings income):

Basic rate taxpayers	£1,000	£1,000
Higher rate taxpayers	£500	£500
Additional rate taxpayers	Nil	Nil

Dividend Allowance	£2,000	£1,000
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Dividend tax rates

Basic rate	8.75%	8.75%
Higher rate	33.75%	33.75%
Additional rate	39.35%	39.35%

Trusts

Standard rate band	£1,000	£1,000
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Rate applicable to trusts

- dividends	39.35%	39.35%
- other income	45%	45%

MAIN PERSONAL ALLOWANCES AND RELIEFS

Income limit for Personal Allowance §	£100,000	£100,000
Personal Allowance (basic) §	£12,570	£12,570
Married/civil partners (minimum) at 10% †	£3,640	£4,010
Married/civil partners at 10% †	£9,415	£10,375
Marriage Allowance	£1,260	£1,260
Income limit for Married Couple's Allowance †	£31,400	£34,600
Rent a Room scheme – tax free income allowance	£7,500	£7,500
Blind Person's Allowance	£2,600	£2,870
Enterprise Investment Scheme relief limit on £2,000,000 max**	30%	30%
Seed Enterprise Investment relief limit on £200,000 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)	£2,935	£3,235
- family element	£545	£545

Threshold for tapered withdrawal of CTC	£17,005	£18,725
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NATIONAL INSURANCE CONTRIBUTIONS

Class 1 Employee

Weekly

Lower Earnings Limit (LEL)	£123
Primary threshold	£242
Upper Earnings Limit (UEL)	£967

Total earnings £ per week

CLASS 1 EMPLOYEE CONTRIBUTIONS

Up to 242.00*	Nil
242.00 – 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 £123 per week. This £123 to £242 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 175.00**	Nil
Over £175.00	13.8%

*** Secondary threshold.*

CLASS 2 (self-employed)

Flat rate per week	£3.45
Small profits threshold per year	£6,725
Lower profits limit per year	£12,570

Class 3 (voluntary)

Flat rate per week £17.45.

Class 4 (self-employed)

9% on profits between £12,570 and up to £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 – 2023/2024*	£1,073,100

**Lifetime allowance charge removed after 5 April 2023. Any excess over the lifetime allowance that would have been subject to a lifetime allowance charge of 55% prior to 2023/2024 will be taxable as the member's pension income via PAYE.*

Maximum tax-free pension commencement lump sum in 2023/2024 is £268,275 unless a higher amount is protected.

ANNUAL ALLOWANCE

TAX YEAR	ANNUAL ALLOWANCE
2014/2015 – 2022/2023	£40,000*
2023/2024	£60,000**

**From 6 April 2016 the annual allowance is reduced for those with income above a certain level. Between 2020/21 and 2022/23 the annual allowance will be reduced 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.*

***Reducing by £1 for every £2 of 'adjusted income' over £260,000 to a minimum of £10,000 if 'threshold income' is also over £200,000.*

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.

MONEY PURCHASE ANNUAL ALLOWANCE	2022/2023	2023/2024
	£4,000	£10,000

CAPITAL GAINS TAX

ANNUAL EXEMPTIONS

	2022/2023	2023/2024
Individuals, estates etc	£12,300	£6,000
Trusts generally	£6,150	£3,000
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:

Residential property	28%	28%
Other chargeable assets	20%	20%

Business Asset Disposal Relief*	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				2022/2023	2023/2024
Transfers made on death					
- Up to £325,000				Nil	Nil
- Excess over £325,000				40%	40%
- Reduced rate (where appropriate charitable contributions are made)				36%	36%
Transfers					
- Lifetime transfers to and from certain trusts				20%	20%
MAIN EXEMPTION					
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
<i>*Available for estates up to £2,000,000 and then tapered at the rate of £1 for every £2 in excess until fully extinguished.</i>					
Lifetime transfers					
- Annual exemption per donor				£3,000	£3,000
- Annual small gifts exemption per donor				£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%

MAIN SOCIAL SECURITY BENEFITS

		2022/2023	2023/2024
		£	£
Child Benefit	First child	21.80	24.00
	Subsequent children	14.45	15.90
	Guardian's allowance	18.55	20.40
Employment and Support Allowance	Assessment Phase		
	Age 16 - 24	Up to 61.05	Up to 67.20
	Aged 25 or over	Up to 77.00	Up to 84.80
	Main Phase		
	Work Related Activity Group	Up to 107.60	Up to 84.80*
	Support Group	Up to 117.60	Up to 129.50
Attendance Allowance	Lower rate	61.85	68.10
	Higher rate	92.40	101.75
Basic State Pension	Category A full rate	141.85	156.20
	Category B full rate	85.00	93.60
New State Pension	Full rate	185.15	203.85
Pension Credit	Standard minimum guarantee - single	182.60	201.05
	Standard minimum guarantee - couple	278.70	306.85
	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	61.05	67.20
	Age 25 or over	77.00	84.80
Statutory Maternity, Paternity and Adoption Pay		156.66	172.48

**If a claim has begun before 3rd April 2017 the individual will also be awarded the Work Related Activity Component payment which in 2023/2024 is £33.70, so total awarded for these individuals may be up to £118.50.*

CORPORATION TAX

	2022/2023	2023/2024
Small profit rate - for taxable profits below £50,000	N/A	19%
Marginal rate – for taxable profits between £50,001 - £250,000	N/A	26.5%
Standard rate - for taxable profits above £250,000	19%	25%

VALUE ADDED TAX

	2022/2023	2023/2024
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 £250,000	0%
£250,001 - £925,000	5%
£925,001 - £1,500,000	10%
£1,500,001 and over	12%

Additional Stamp Duty Land Tax (SDLT) rules apply as follows:

- *First-time buyers benefit from SDLT relief on first £425,000 for properties up to £625,000 when purchasing their main residence. On purchases up to £425,000, no SDLT is payable. On purchases between £425,001 and £625,000, a flat rate of 5% is charged on the balance above £425,000.*
- *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.*
- *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.*

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

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