Chartered Insurance Institute

AF4

Advanced Diploma in Financial Planning

Unit AF4 – Investment planning

March 2024 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.

Silvia is an independent financial adviser within an authorised firm. She is preparing for an annual review meeting with Tadeusz. Tadeusz, aged 48, is an architect and runs his own practice. He is a higher-rate taxpayer. His objective is long-term capital growth, and he has a high attitude to risk in order to help him achieve his objective. Over the past two decades, upon completion of individual projects, he has invested ad-hoc lump sums into a single collective fund within a general investment account (GIA) which has a current value of £320,000.

The fund, Reykjanes Global Opportunities, is a global equities open-ended investment company (OEIC) that invests in listed mid and small cap companies in developed economies. For several years, the growth style of the fund's manager resulted in high annual returns but in recent months, the fund's value has fallen substantially.

Financial details from the fund's most recent factsheet are set out in **Table 1** below:

Table 1

Expected return of fund	Previous 12-month return	Risk-free rate	Expected return of market
8.5%	-27%	4.3%	6%

The fund's commentary states that changes in globalisation and declining gross domestic product (GDP) are the main contributors to the recent performance, but Silvia is concerned that the fund manager's style may have fallen out of favour. As a result, she is looking at similar funds but with different investment styles and believes that a growth at a reasonable price (GAARP) strategy may be more suited to Tadeusz's objective.

In analysing the OEIC's recent returns, Silvia has identified that the funds 3-year alpha is slightly positive but would like to undertake a more comprehensive evaluation of the risk-adjusted returns.

Tadeusz also owns a small industrial unit that is let to a local business. Due to increases in tax rates and higher maintenance costs, he is looking to sell the unit and re-invest the proceeds. Tadesuz would like to retain exposure to physical commercial property and has asked Silvia to research alternate investment options using collective funds. While Tadeusz is optimistic about the prospects for commercial property, Silvia wants to highlight that specific risks remain.

The combination of this potential investment and the fall in the value of the OEIC has prompted Silvia to consider portfolio optimisation using Stochastic modelling, in preparation for the review meeting.

Questions

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

(a) Outline **nine** factors that Silvia would take into consideration when conducting the annual review with Tadeusz. **(9)**

(b) **(i)** Describe what beta represents and what it measures. **(4)**

(ii) Calculate, **showing all your workings**, the beta of Reykjanes Global Opportunities. **(5)**

(iii) Explain briefly the limitations of using beta as a measure of risk. **(3)**

(c) Identify the main differences between GAARP and growth investing. **(3)**

(d) State the **two** main risk-adjusted ratios used to analyse an actively-managed fund and explain briefly what each ratio measures. *Exclude alpha from your answer.* **(6)**

(e) **(i)** State the main rules that a fund must adhere to in order to qualify as a real estate investment trust (REIT). **(8)**

(ii) State the **two** types of income payment that can be made by a REIT and describe their tax treatment if received by Tadeusz within the GIA. **(8)**

(f) **(i)** Outline **four** benefits of introducing commercial property to the asset allocation of Tadeusz's GIA portfolio. **(4)**

(ii) Identify **four** main risks when investing in physical commercial property through open-ended collective funds and state **one** reason for **each** risk. **(8)**

QUESTIONS CONTINUE OVER THE PAGE

(g) **(i)** State **four** of the main assumptions used in portfolio optimisation. **(4)**

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

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

(h) **(i)** Describe what is meant by GDP and what it measures. **(5)**

(ii) Explain briefly from an investment perspective the consequences of globalisation. **(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) and (d) which follow.

George, aged 45, and Rosemary, aged 44, are married. They have two children; Leo, aged 17 and Freya, aged 14. George and Rosemary are both employed and are higher-rate taxpayers. Their disposable income allows them to consider fully utilising the ISA allowances for each member of the family in the current tax year.

They already hold some ISA products and details of their contributions to these existing ISAs in the current tax year to date is set out in **Table 1** below:

Table 1

Holder	ISA Type	Contributions to date in the 2023/2024 Tax Year
George	Innovative Finance	£4,000
Rosemary	Cash	£7,000
Leo	Junior	£3,600

Leo and Freya also each have a friendly society policy.

Details of the friendly society policies are set out in **Table 2** below:

Table 2

Holder	Premium Level	Premium Frequency
Leo	£20	Monthly
Freya	£150	Annually

In previous tax years, George has tended to invest into a stocks and shares ISA and Rosemary into a cash ISA. This position is not fixed for the current tax year and they will consider different ISA products if these support their objective of achieving capital growth until retirement. The combined value of George and Rosemary's ISAs is £165,000, of which the stocks and shares portion is valued at £78,000. This consists of equal holdings in eight blue chip UK equities. Following a lack of performance, they are considering selling the direct equities and investing into frontier markets via a collective fund. Their financial adviser has suggested that a fund applying a top-down investment approach may be suitable and George and Rosemary would like to know more about collective funds and this approach.

Marketing communication from their ISA provider includes a shortlist of preferred funds, which are managed on a mix of active and passive basis and their financial adviser is assessing both types of investment style.

Questions

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

(a) Calculate, **showing all your workings**, the total **additional** amount that the family can pay into **all** eligible ISA products in the 2023/2024 tax year. *Your answer should identify the relevant ISA products for each family member.* **(9)**

(b) **(i)** Explain briefly the tax treatment of friendly society policies within the fund and in the hands of the investor. *Exclude the contribution limits from your answer*. **(4)**

(ii) Calculate, **showing all your workings**, the total **additional** amount that Leo and Freya could pay into their friendly society policies over the next policy year. *Assuming their current contributions continue*. **(4)**

(c) **(i)** Identify **five** benefits of investing in a frontier markets equities fund, compared to holding direct UK equities. **(5)**

(ii) State the main stages of the top-down investment process for a frontier markets equities fund. **(3)**

(iii) Explain briefly the main investment-related factors that George and Rosemary would take into consideration when deciding whether to choose active or passive strategies for the investment into a collective fund. **(7)**

(d) State **four** main benefits and **four** main drawbacks of using a stocks and shares ISA as a long-term savings vehicle for retirement, compared to a personal pension plan. **(8)**

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 (e) which follow.

Naomi is an adviser within an authorised firm of independent financial advisers. The firm has an association with an accountancy practice and Naomi has been asked to attend a meeting with Kambiz, an existing client of the accountancy practice.

Kambiz sold his business in February 2024 that resulted in a likely gain of £450,000 for Capital Gains Tax (CGT) purposes in the 2023/2024 tax year. In addition to his shareholding, Kambiz has been employed as sales director of the business on a salary of £90,000 per annum for the past few years. While Kambiz is pleased with the value of the sale, he would like to mitigate his personal tax liability and has approached Naomi with a view to discussing the tax planning opportunities available from investing into tax-sheltered products for the first time.

Naomi feels that the discussion may concentrate too heavily on the potential benefits of tax planning without considering the potential drawbacks. The accountancy practice has previously been involved in the launch of single company Enterprise Investment Schemes (EISs) for other clients and Naomi is considering the differences between Venture Capital Trusts (VCTs) and EISs, as well as between a single company EIS and an EIS portfolio, (also known as a managed EIS or EIS fund).

Naomi has been provided with recent correspondence from Bio Mesal plc, a UK-listed investment trust in which Kambiz has been invested since its original listing. During this period, Kambiz has acquired both warrants and convertible loan stock in the trust.

Financial information on Bio Mesal plc, is set out in **Table 1** below.

Table 1

Number of ordinary shares	7,200,000
Number of warrants	840,000
Number of convertible loan notes	5,000,000
Current ordinary share price	160p
Undiluted NAV per share	250p
Conversion discount to ordinary share price	20%
Warrant exercise price	90p

The correspondence indicates that the trust is seeking to raise capital as part of a strategic review. It is also offering both warrant and convertible loan note holders the opportunity to subscribe to new ordinary shares on a one-for-one basis by exercising their holdings at the pre-determined prices.

Questions

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

(a) State **three** ways in which an investment trust can raise capital. **(3)**

(b) **(i)** Describe briefly the concept of dilution in relation to the investment trust. **(3)**

(ii) Calculate, **showing all your workings**, the **diluted** NAV per share for Bio Mesal plc. *Assume that the current share price is unchanged, and all of the warrants and convertible notes are exercised.* **(9)**

(iii) Comment, based upon your answer to **part (b)(ii) above**, the difference in the diluted NAV per share compared to the undiluted NAV per share, and its significance. **(3)**

(c) **(i)** State the time limits for reinvestment of the proceeds into an EIS within which CGT deferral relief would be available to Kambiz. **(3)**

(ii) Calculate, **showing all your workings**, the maximum Kambiz could invest into a new EIS and receive Income Tax relief. *Assume that Kambiz has not previously invested into an EIS and that his salary has been his only income.* **(8)**

(d) Outline the main differences between the tax treatment of an EIS and a VCT, if Kambiz wanted to invest some of the sale proceeds into either product. **(5)**

(e) **(i)** Identify **three** main benefits of investing into an EIS portfolio compared to a single company EIS. **(3)**

(ii) Identify **three** main drawbacks of investing into an EIS portfolio compared to a single company EIS. **(3)**

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.*

	2022/2023	2023/2024
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
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
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.*

	2022/2023	2023/2024
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

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% / 10%**
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.*

***From 6 April 2023 to 5 January 2024, 12% rate applies, from 6 January 2024 to 5 April 2024, 10% rate applies.*

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

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

Lifetime transfers		
- Annual exemption per donor	£3,000	£3,000
- 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 minimumguarantee - 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 mainresidence. 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. Therates 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%

BLANK PAGE

BLANK PAGE

BLANK PAGE