



Chartered
Insurance
Institute

AF4

Advanced Diploma in Financial Planning

Unit AF4 – Investment planning

October 2024 examination

SPECIAL NOTICES

All questions in this paper are based on English law and practice applicable in the tax year 2024/2025, unless stated otherwise in the question, and should be answered accordingly.

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

Instructions

- Three hours are allowed for this paper.
- **Do not begin writing until the invigilator instructs you to.**
- **Read the instructions on page 3 carefully before answering any questions.**
- Provide the information requested on the answer book and form B.
- You are allowed to write on the inside pages of this question paper, but you must **NOT** write your name, candidate number, PIN or any other identification anywhere on this question paper.
- The answer book and this question paper must **both be handed in personally by you** to the invigilator before you leave the examination room. **Failure to comply with this regulation will result in your paper not being marked and you may be prevented from entering this examination in the future.**

Unit AF4 – Investment planning

Instructions to candidates

Read the instructions below before answering any questions

- **Three hours** are allowed for this paper which carries a total of 160 marks as follows:
 - Section A: 80 marks
 - Section B: 80 marks
- You are advised to spend approximately 90 minutes on Section A and 90 minutes on Section B.
- You are strongly advised to attempt **all** questions to gain maximum possible marks. The number of marks allocated to each question part is given next to the question and you should spend your time in accordance with that allocation.
- Read carefully all questions and information provided before starting to answer. Your answer will be marked strictly in accordance with the question set.
- You may find it helpful in some places to make rough notes in the answer booklet. If you do this, you should cross through these notes before you hand in the booklet.
- It is important to show all steps in a calculation, even if you have used a calculator.
- If you bring a calculator into the examination room, it must be a silent, battery or solar-powered, non-programmable calculator. The use of electronic equipment capable of being programmed to hold alphabetic or numerical data and/or formulae is prohibited. You may use a financial or scientific calculator, provided it meets these requirements.
- Tax tables are provided at the back of this question paper.
- Answer each question on a new page and leave six lines blank after each question part.

Subject to providing sufficient detail you are advised to be as brief and concise as possible, using note format and short sentences on separate lines wherever possible.

SECTION A

This question is compulsory and carries 80 marks

Question 1

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

Cassie and Tasuku are married and both in their late-50s. They are currently employed, and higher rate taxpayers. Within the next few years, they plan to stop working. They have arranged a review meeting with their financial adviser, Simon.

Their investments are held in their individual names as they have different attitudes to risk. Cassie has a low attitude to risk. Her portfolio is held on a platform and consists of an onshore investment bond and a general investment account (GIA). The portfolio's current value is £150,000 and it is invested in a UK fixed interest collective fund. In the most recent fund factsheet, the Manager commented that the fund's duration had increased significantly, although Cassie does not fully understand what this means.

Tasuku has a medium attitude to risk. Tasuku's portfolio consists of a Stocks and Shares ISA that is invested in a UK equities collective fund. The equities fund is managed on a flexible approach, with the manager switching between value and growth investment styles. Tasuku noted the terms r-squared and regression analysis when reading the fund's performance commentary and has asked Simon to explain these terms in more detail.

Recent financial details of Tasuku's ISA are as set out in **Table 1** below:

Table 1

| Valuation at start of tax year | Dividends paid out over the year | Additional investment after 7 months | Valuation at end of tax year |
|--------------------------------|----------------------------------|--------------------------------------|------------------------------|
| £81,000 | £2,670 | £20,000 | £110,000 |

During the 1980s and 1990s Cassie and Tasuku took out a number of endowment policies. These were originally intended to repay a mortgage but as this was repaid from inheritances, the policies became long-term savings plans. One policy matured in 2020 and the proceeds were invested into a structured product at issue, FTSE Accelerator Six, details of which are set out in **Table 2** below:

Table 2

| Start Date | Term | Auto-call | Participation rate | Protection | Barrier type |
|------------|---------|-----------|--------------------|-------------|--------------|
| June 2020 | 6 years | Yes | 135% | 70% barrier | European |

Another policy is due to mature within the next three months and Cassie and Tasuku would like Simon to suggest potential re-investment opportunities. As a result of higher interest rates, they have read about potentially attractive returns from National Savings & Investments (NS&I) products and have asked him for more information about them. Simon also believes that Income Bonds or Green Savings Bonds may be worthy of consideration as Cassie and Tasuku are considering taking the interest and distributions from their investments to generate an additional income stream.

Questions

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

- (a) (i) Outline briefly, the tax treatment of the income stream, should Cassie begin to take regular withdrawals from her investment bond and general investment account (GIA). Assume no chargeable event occurs. No calculations are required in your answer. (8)
- (ii) Identify **four** benefits of investing via a GIA compared to an onshore investment bond. (4)
- (b) (i) Describe briefly what is measured by Macaulay duration. (6)
- (ii) Explain briefly how **Macaulay** duration would be used within a fixed interest portfolio. (2)
- (iii) Explain briefly how **modified** duration would be used within a fixed interest portfolio. (2)
- (iv) Identify **five** economic **or** market factors that would likely cause an increase in the duration of a fixed interest fund. (5)
- (c) Describe the main characteristics of growth and value investment strategies. (10)
- (d) (i) Explain the objective of regression analysis and identify **two** ways in which it can be applied in investment planning. (4)
- (ii) Explain what is measured by the r-squared value in respect of the fund. (4)
- (e) (i) Calculate, **showing all your workings**, the money-weighted rate of return (MWR) for the UK equities fund. (10)
- (ii) State **three** drawbacks of using the MWR. (3)

QUESTIONS CONTINUE OVER THE PAGE

-
- (f) (i) Comment on the structure and operation of FTSE Accelerator Six from the information contained in **Table 2**. (4)
- (ii) Identify **four** main risks of investing in structured products and state **one** example of **each** type of risk. (8)
- (g) (i) Outline the main features of NS&I Income Bonds. (7)
- (ii) State **three** reasons why NS&I Income Bonds may be more suitable than NS&I Green Savings Bonds for Cassie and Tasuku. (3)

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.

Charlie, aged 49, has an existing investment portfolio. The portfolio's current value is £275,000 and it is invested solely in a fund of funds (FoF). The portfolio was recommended by Charlie's financial adviser, Belmira.

Charlie recently received an inheritance and is considering making an additional investment into the portfolio. He has asked for a meeting with Belmira and in preparation for their discussion, she is considering potential investment options. The investment style of the FoF places strong reliance on the Capital Asset Pricing Model (CAPM) and Belmira wants to explain to Charlie the benefits of CAPM.

Recent financial details of the FoF are set out in **Table 1** below:

Table 1

| Past 12 months' return | Expected market return | Risk-free rate of return | Beta |
|------------------------|------------------------|--------------------------|------|
| 7.1% | 6.25% | 4.5% | 0.9 |

Belmira's firm was recently acquired by a larger financial services business and will soon be offering existing clients access to its model portfolio service (MPS) and discretionary investment manager (DIM) propositions. Belmira believes that one of these could be suitable for the new investment within the portfolio.

In light of the unexpected capital sum, Charlie is reconsidering his existing investment objective. Belmira has suggested that it may also be appropriate to review the benchmark(s) used for the existing portfolio and any new investment at the same time.

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 expected return for the existing portfolio, based upon the Capital Asset Pricing Model (CAPM). (5)
- (ii) State **four** benefits of using the CAPM. (4)
- (b) (i) Outline **three** main differences between a fund of funds (FoF) service and a managed portfolio service (MPS). (3)
- (ii) Identify **five** provider-related factors that an adviser would take into consideration when evaluating a DIM service. (5)
- (iii) Identify **four** main risks of using a DIM service compared to investing in a FoF. (4)
- (c) (i) Identify and explain briefly the **four** main investor return objectives. (8)
- (ii) State **five** main client-related factors that impact investment returns and a portfolio's capability to achieve its objectives. (5)
- (d) State the **three** main types of benchmark and describe briefly the purpose of **each** type. (6)

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.

Inita is an investment analyst within an authorised firm. The firm holds permission to trade in direct equities. Inita is preparing for a meeting with an existing client, Jaume. Jaume has an investment portfolio that consists of a Stocks and Shares ISA with a current value of £120,000 and an Innovative Finance ISA (IFISA) with a current value of £70,000. Jaume uses the Stocks and Shares ISA to trade direct equities himself, approaching Inita for information when he is assessing potential new investee companies.

Within the Stocks and Shares ISA, Jaume is currently considering whether to invest in Silver Elliptical plc. Recent financial information on the company is set out in **Table 1** below:

Table 1

| | |
|-------------------------|--------------|
| Turnover | £67,000,000 |
| Operating profit/(loss) | (£2,150,000) |
| Tax and interest | £4,400,000 |
| Current assets | £3,200,000 |
| Fixed assets | £7,750,000 |
| Current liabilities | £8,200,000 |
| Long-term liabilities | £22,550,000 |

Jaume has studied the most recent accounts for Silver Elliptical plc and wants to understand more about the company from its published financial information. In particular, he believes that the return on capital employed (ROCE) and working capital ratios deserve closer attention and has asked Inita to analyse these.

Silver Elliptical plc has recently announced it intends to move from AIM to a main market listing. The company has said that in addition to UK markets, it is exploring an overseas listing because of how other stock market indices are weighted.

Having invested in the early years following their launch, Jaume has not invested subsequently into his IFISA, as a result of media coverage around IFISAs. However, he has asked Inita to refresh his understanding of this type of investment and the risks associated with it, compared to investing in direct equities via his Stocks and Shares ISA.

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 operating profit margin for Silver Elliptical plc. (4)
- (ii) Calculate, **showing all your workings**, the ROCE for Silver Elliptical plc. (8)
- (iii) Comment on what can be deduced from the ROCE figure, based upon your answer to **part (a)(ii) above**. Assume that the average ROCE of companies in the same sector is 18%. (3)
- (b) (i) Calculate, **showing all your workings**, the working capital ratio for Silver Elliptical plc. (3)
- (ii) Based upon the figures contained in **Table 1** and your answer to **part (b)(i) above**, comment on Silver Elliptical plc's working capital position. (3)
- (c) (i) Outline briefly the main differences between current and non-current assets on a company's balance sheet. (3)
- (ii) State **two** categories of assets that would be found under **each** of the Current and Non-Current headings of a company's balance sheet. (4)
- (d) (i) Identify **three** differences in the main listing criteria between AIM and the UK main market. (3)
- (ii) Describe briefly how a market capitalisation-weighted index is constructed. (4)
- (e) (i) State **two** asset types that are permissible investments within an IFISA. (2)
- (ii) Identify **three** main risks specific to investing in an IFISA. (3)

Total marks available for this question: 40

The tax tables can be found on pages 13 – 19

INCOME TAX

| RATES OF TAX | 2023/2024 | 2024/2025 |
|---|---|-----------|
| 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 | £125,140 | £125,140 |
| High income child benefit charge: | 1% of benefit per £200 of adjusted net income between £60,000 – £80,000 | |

*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 | £1,000 | £500 |
| 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 | n/a |
| Income exemption up to** | n/a | £500 |
| Rate applicable to trusts | | |
| - dividends | 39.35% | 39.35% |
| - other income | 45% | 45% |

** Where net income exceeds £500, the full amount is subject to Income Tax.

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% † | £4,010 | £4,280 |
| Married/civil partners at 10% † | £10,375 | £11,080 |
| Marriage Allowance | £1,260 | £1,260 |
| Income limit for Married Couple's Allowance † | £34,600 | £37,000 |
| Rent a Room scheme – tax free income allowance | £7,500 | £7,500 |
| Blind Person's Allowance | £2,870 | £3,070 |
| 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. Married couple's/civil partners' allowance reduced by £1 for every £2 of adjusted net income over £37,000 (£34,600 for 23/24) until minimum reached.

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

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 | 8% |
| 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

Class 2 contributions are credited automatically where profits equal or exceed £6,725 per annum.

Class 2 contributions can be made voluntarily where profits are below £6,725 per annum.

Class 3 (voluntary)

Flat rate per week £17.45.

Class 4 (self-employed)

6% on profits between £12,570 and up to £50,270.

2% on profits above £50,270.

PENSIONS

| TAX YEAR | LIFETIME ALLOWANCE |
|------------------------|--------------------|
| 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 removed from 6 April 2024.

| | 2023/2024 | 2024/2025 |
|--|-----------|------------|
| Lump sum and death benefit allowance (LSDBA) | n/a | £1,073,100 |
| Lump sum allowance (LSA) | n/a | £268,275 |
| LSA and LSDBA may be higher if transitional protections are available. Where pension benefits were crystallised prior to 6 April 2024 the LSA and LSDBA may be reduced. | | |
| Money purchase annual allowance | £10,000 | £10,000 |

ANNUAL ALLOWANCE

| TAX YEAR | ANNUAL ALLOWANCE |
|-----------------------|------------------|
| 2014/2015 – 2022/2023 | £40,000* |
| 2023/2024 | £60,000** |
| 2024/2025 | £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.

CAPITAL GAINS TAX

| ANNUAL EXEMPTIONS | 2023/2024 | 2024/2025 |
|---|------------|------------|
| Individuals, estates etc | £6,000 | £3,000 |
| Trusts generally | £3,000 | £1,500 |
| 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 - Basic Rate | 8% | 8% |
| Higher Rate | 8% | 4% |
| Surcharge for carried interest | 8% | 8% |
| Trustees and Personal Representatives: | | |
| Residential property | 28% | 24% |
| 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 | 2023/2024 | 2024/2025 |
|--|-----------|-----------|
| 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 |

Gifts from surplus income are immediately exempt, as long as they are made from income, are made regularly and do not impact donor's standard of living.

| | | |
|------------------------------------|--------|--------|
| 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 made in excess of the nil rate band 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

| | | 2023/2024 | 2024/2025 |
|---|---|--------------|---------------|
| | | £ | £ |
| Child Benefit | First child | 24.00 | 25.60 |
| | Subsequent children | 15.90 | 16.95 |
| | Guardian's allowance | 20.40 | 21.75 |
| Employment and Support Allowance | Assessment Phase | | |
| | Age 16 - 24 | Up to 67.20 | Up to 71.70 |
| | Aged 25 or over | Up to 84.80 | Up to 90.50 |
| | Main Phase | | |
| | Work-related Activity Group | Up to 84.80* | Up to 90.50** |
| | Support Group | Up to 129.50 | Up to 138.20 |
| Attendance Allowance | Lower rate | 68.10 | 72.65 |
| | Higher rate | 101.75 | 108.55 |
| Basic State Pension | Category A full rate | 156.20 | 169.50 |
| | Category B (lower) full rate | 93.60 | 101.55 |
| New State Pension | Full rate | 203.85 | 221.20 |
| Pension Credit | Standard minimum guarantee - single | 201.05 | 218.15 |
| | Standard minimum guarantee - couple | 306.85 | 332.95 |
| | 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 | 67.20 | 71.70 |
| | Age 25 or over | 84.80 | 90.50 |
| Statutory Maternity, Paternity and Adoption Pay | | 172.48 | 184.03 |

**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.*

***If a claim has begun before 3rd April 2017 the individual will also be awarded the Work-related Activity Component payment which in 2024/2025 is £35.95, so total awarded for these individuals may be up to £126.45.*

CORPORATION TAX

| | 2023/2024 | 2024/2025 |
|--|-----------|-----------|
| Small profit rate - for taxable profits below £50,000 | 19% | 19% |
| Main rate - for taxable profits above £250,000 | 25% | 25% |
| Companies with profits between £50,000 and £250,000 will pay tax at the main rate, reduced by a marginal relief. This provides a gradual increase in the effective Corporation Tax rate. | | |

VALUE ADDED TAX

| | 2023/2024 | 2024/2025 |
|-------------------------------|-----------|-----------|
| Standard rate | 20% | 20% |
| Annual registration threshold | £85,000 | £90,000 |
| Deregistration threshold | £83,000 | £88,000 |

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% |

BLANK PAGE

BLANK PAGE

BLANK PAGE

