

Diploma in Investment Planning

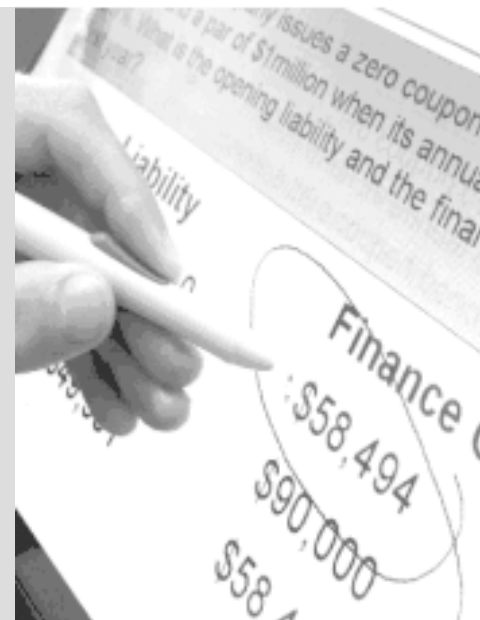


Specimen Examination

2010/2011

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Time allowed: 3 hours 15 minutes



Section 1 Case Study (40 marks)

Susan McLean is a Bond dealer in the City of London, with a large Investment Bank, Sheraton Brothers. She has held this position for almost ten years, and is well rewarded albeit on a fluctuating basis each year. Susan often can be heard to boast that she has no real fear of redundancy since she is “one of the best” at her job.

Susan is age 35 and is a keep-fit fanatic, regularly running marathons at home and abroad – which keeps her in very good health, and loves to travel the world. She readily admits that her limited edition Ferrari Testarossa, paid for from a cash bonus she received a few years ago, is her prized possession! This car is much sought after and is valued at around £80,000. Sadly, Susan has very little time to make use of the car which is garaged, and so she is considering selling it.

Although Susan works in a very high powered and very well paid job in the City, she openly admits to having very little knowledge of personal financial matters, and is seeking advice from you to help her reorganise her financial affairs. She does feel that her personal finances are in “a bit of a mess” simply because of her rather hectic business life, and would welcome some impartial and objective advice.

Susan lives in a two-bedroom studio apartment in Bracknell on the Waterloo Line. She shares the property with her partner, Mark. She has a daily commute of just over an hour to her job in the City but likes the rural life offered in the Stockbroker Belt, given her passion for running. The flat cost just over £450,000 when purchased six years ago with a 100% variable interest rate repayment mortgage, which she and Mark secured on a joint basis. Regarding her relationship, Susan stresses that her career means everything to her and states that it is highly unlikely that she and Mark, having been an item for over ten years, will ever marry. The amount outstanding on the mortgage is currently £430,000.

Her employment income fluctuates wildly each year reflecting in part the vicissitudes of the Corporate Bond Market and the fact that a large portion of her remuneration package is bonus driven. Her base salary is a “mere” £80,000 but her total package has exceeded £350,000 twice in the last three years. She has £90,000 deposited in various bank accounts, none of which currently pays any meaningful rate of interest.

Susan contributes 5% of her basic salary to a Company Pension Scheme and her employer contributes a further 7.5%. The pension scheme is a defined contribution scheme and under the terms of the scheme she can retire at age 55. She has Private Healthcare insurance as one of her employer benefits, and mentioned that she also has a decreasing term assurance policy to cover the repayments on her share of the mortgage, in the event of her death.

Susan has concerns over the investment in property she has made. The current economic climate has seen property values in and around London falling so dramatically, that a lot of similar properties in the area are vacant, with the current valuation on the flat being around £380,000.

Susan feels that her cash assets are overly concentrated – and that the time has come to consider a reorganisation of her finances. She is prepared to accept a fairly high degree of risk, in order to gain what she would regard as an above average return.

- (a) She asks you to give her an outline of a spread of investments using the £90,000 she currently has deposited in the bank. **(3 marks)**
- (b) When you have completed this recommendation, she queries your split. Explain to Susan why you have created the Portfolio you have, justifying the various percentages used. **(6 marks)**
- (c) Susan then asks what differences you might suggest to her if she decided to sell her car, and realise the capital. Again, you feel the need to justify your answer. **(9 marks)**
- (d) Susan then asks you about the risks involved with equity investments **(6 marks)**

(e) Having agreed to your suggested portfolio, Susan then asks if there are any ways in which she can mitigate any tax demands on the suggested portfolio. **(6 marks)**

(f) Finally, Susan turns to her pension. Although currently a workaholic she has set her mind on retirement as soon as possible. However, she wonders what effect retiring at age 55 will have on her pension entitlement, and what steps she can take now, to ensure that her pension income is not significantly below her current basic salary. Explain to Susan what her current pension fund is likely to provide at age 55, and what she is allowed to do by way of making extra contributions .

(10 marks)

(Total 40 marks)

Section 2 Investment Case Study (15 marks)

Jack Blackwell, one of the administrative assistants in your office was getting into a quite heated argument the other day with another work colleague. The argument centred around a decision which had been made by one of your Firm's most highly valued clients who, via his Self Invested Personal Pension, had decided against any form of direct stock market based investment in favour of a collective investment approach.

This client had for a long while always been a stock picker but lately had confided in Jack that the decision he was now making was in his view the only way ahead for sensible long-term equity investors. His decision had now extended to whether or not he should back an Active Fund Manager approach or a more Passive investment philosophy.

Meanwhile, Jack was indeed lamenting that there are many "Star Managers" around and in his view the more active approach from one or more of these "stars" was in his view, definitely the way ahead – a view incidentally not shared by his colleague with whom the argument had arisen.

The same client also favoured a lump sum approach which given the level of the market, Jack happened to agree with. It was no surprise therefore that his colleague was in total disagreement, favouring a far more gradual approach to investment in the volatile market conditions we are experiencing such that the client would then benefit from "Pound Cost Averaging".

Your secretary, who has been around "more years than she cares to remember" seemed to find this healthy but lively debate on the whys and wherefores of one client's investment preferences, highly amusing. She did however admit that she "had not got a clue what it was the two were arguing about!"

- (a) Evaluate the main differences in an Active versus a Passive approach to running an investment portfolio, taking into account the way the stock exchange has performed over the past 6 months. **(6 marks)**
- (b) Your secretary asks you to briefly explain what is meant by Pound Cost Averaging. **(3 marks)**
- (c) She still looks puzzled so you decide to show her how it works. Before doing so you ask her to find out the price of units from a Unit Trust on the first business day of each month over the past year. She returns with the following figures:

	Price of units
Jan	100p
Feb	90p
Mar	85p
Apr	85p
May	78p
June	82p
July	90p
Aug	100p
Sept	110p
Oct	125p
Nov	100p
Dec	95p

Taking a suitable investment figure, show how Pound Cost averaging works and what effect it would have had if this approach had been taken by an investor in the unit trust selected. **(6 marks)**

(Total 15 marks)

Section 3 Taxation Case Study (15 marks)

Nigel and Joanne Tutt had been married for 41 years when Nigel died in November 2006, aged 76. He left his entire estate, valued at £400,000, to Joanne. He had not made any gifts or transfers of assets in the ten years prior to his death, apart from a transfer of £30,000 of unit trust investments from his own name to that of Joanne in August 2005.

In July 2007, Joanne gave each of her two daughters, Rachel and Rebecca, a cash gift of £50,000. Joanne made no other gifts and died in January 2010, leaving an estate consisting of the following assets:

	£
■ Main home in her sole name	475,000
■ Equity ISAs	58,000
■ Cash ISAs	33,000
■ Unit trust and investment trust holdings	42,000
■ Gilts	96,000
■ Corporate bonds	52,000
■ Bank account	2,000

Joanne left her entire estate to be divided equally between her daughters, apart from a bequest of £25,000 to a cancer research charity.

- (a) Calculate the amount of inheritance tax payable on Joanne's estate. Show all your workings.
(12 marks)
- (b) Prior to Joanne's death, what steps could she have taken to reduce the value of her estate for IHT purposes?
(3 marks)

(Total 15 marks)

Section 4 Pensions and Retirement Planning Case Study

(15 marks)

You have arranged to meet with Duncan and Moira Stuart and Moira's brother Jack. Your assistant has put together the following information to assist you during the meeting.

Duncan Stewart is 39 years old and has been married to Moira, who is aged 36, for five years. The couple have two children – Thomas who is four years old and Hannah who is two. Duncan works as a design engineer for a local company and has just been promoted to lead a team of engineers that will work on a new project for a major client. Duncan now enjoys an increased annual salary of £52,000 and is a member of his employer's defined contribution pension scheme, to which he contributes 6% of his salary. He has calculated that his pension fund should be worth at least £500,000 when he retires at age 60, assuming that his own contributions and those of his employer continue at the same level. On retirement, scheme members are permitted to use the open market option.

Moira works as a part-time administrator at her local leisure centre. She is paid an annual gross salary of £5,000 and does not qualify for membership of her employer's pension scheme, although she is considering contributing to a stakeholder pension.

Moira's brother, Jack, a wealthy entrepreneur, is the trustor/settlor of a bare trust that he has recently established for Moira, as sole beneficiary, with a sum of £100,000. Jack and his family solicitor are the trustees of the trust. Jack is also interested in investing £150,000 in a venture capital trust, as he has heard that there are tax advantages in doing so, although he understands that this would be a higher risk investment.

- (a) Duncan asks you to explain to him what is meant by the 'open market option' that is available to him on his retirement. (3 marks)
- (b) Give three criteria or minimum standards that must be met to enable a personal pension to be marketed as a stakeholder pension. (3 marks)
- (c) Jack enquires as to the income tax advantages that would apply if he were to invest £150,000 in a venture capital trust. (4 marks)
- (d) What rights, if any, does Moira have, as beneficiary, in respect of the capital and income of the bare trust? (5 marks)

(Total 15 marks)

Section 5 Income Protection Case Study (15 marks)

Emma and Paul are a married couple, each aged 25 years with three young children. They set up a home together six years ago. Last year they bought their first house, taking out a capital repayment mortgage of £80,000 over 25 years on a standard variable rate..

Since buying their property, the family's financial circumstances have improved. Paul has finished his examinations and has been promoted with a significant salary increase. He now earns £30,000 per annum. Emma is not working at present but intends to return to work when her youngest two children are of school age.

Until now, money has been extremely tight, as they borrowed as much as their income allowed to ensure they could purchase the house they wanted. For the first time, they can consider their protection needs as they have disposable income each month, and have a modest level of savings in their building society.

Emma and Paul have no insurance products except the buildings and contents policy on their home.

Paul has been told by his grandfather that he will shortly receive £20,000 from the proceeds of an investment set aside for him.

- (a) Paul is particularly concerned about the family's financial circumstances should anything happen to him or his job. He asks for your advice on suitable products which will protect the family's lifestyle, as far as is possible, (should anything untoward happen). **(6 marks)**
- (b) You remind Paul that should anything happen to Emma then he would need to make alternative arrangements for the care of his children. What products would you suggest to Paul and Emma as being suitable for this, and why? **(4 marks)**
- (c) Whilst lack of money is now less of an issue, Paul and Emma would like to use £5,000 of the funds coming from his Grandfather for a holiday but they seek your advice on what they should do with the remaining £15,000. **(5 marks)**

(Total 15 marks)

END OF EXAM