# THE CHARTERED INSURANCE INSTITUTE

# CF5

# Certificate in Financial Planning

## Unit 5 – Integrated financial planning

### April 2012 examination

**SPECIAL NOTICES**

**All questions in this paper are based on English law and practice applicable in the tax year 2011/2012, unless stated otherwise and should be answered accordingly.**

**Assume all individuals are domiciled, resident and ordinarily resident in the UK unless stated otherwise.**

**Candidates should answer based on the legislative position immediately BEFORE the 2012 budget.**

## Instructions

- Two 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 CF5 – Integrated financial planning

## Instructions to candidates

## Read the instructions below before answering any questions

- **Two hours** are allowed for this paper which carries a total of 100 marks.
- You are advised to spend approximately 60 minutes on each question. You are strongly advised to attempt **all** parts of each question in order to gain maximum possible marks for each question. 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 have been provided with a **product list** on pages 8 to 11 which you should use when answering **question 2**. You may also find it helpful to use the **tax tables** on pages 12 to 15 when answering both questions.
- 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.
- 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.** |

**Attempt ALL questions**

**Time: 2 hours**

**You are advised to spend no more than approximately:**

**60 minutes on question 1**
**60 minutes on question 2**

**You are advised to take into account the number of marks allocated to each question part when deciding how long to spend on each part.**

**Question 1**

You are authorised to conduct business under the Financial Services and Markets Act (FSMA) 2000 and are qualified to provide financial advice. The information provided is accurate and adequate for the purpose of these questions.

Read the following carefully, then carry out **ALL** of the tasks **(a)**, **(b)**, **(c)**, **(d)**, **(e)** and **(f)** which follow.

**INFORMATION**

Margaret, aged 46, is divorced with one daughter, Angela, aged 12. From previous jobs she has two paid-up pension benefits, one in a final salary 1/60th company pension scheme where she accrued 12 years service. Her salary when she left was £48,000 per annum. Margaret then started a personal pension plan (PPP) as her next employer did not offer any pension arrangements. The current fund value with that arrangement is £10,000.

For the last three years, Margaret has contributed £200 per month, net, to a separate PPP as she is now working as an employee in a consultancy business. Her employer makes no contribution to her pension arrangements. Margaret continues to make this contribution but would like to consider a single premium. Her income for the last three years has been £40,000 per annum.

Margaret says that whilst she thinks she understands the general principles of pension arrangements, she would like a clear explanation of the difference between her final salary pension benefits and her other pension arrangements.

Margaret has a capital and interest repayment mortgage of £50,000 which has a remaining term of 13 years. She has a life assurance and Critical Illness policy covering her mortgage. She has no other outstanding debts. Margaret is concerned that a serious illness or accident would prevent her from working, which would result in a loss of income and would have an immediate effect on her ability to maintain payment of her mortgage.

She has asked for your advice on how to protect her income. Margaret is also concerned that she should provide for Angela in the event of premature death. She requires life cover until Angela's 21st birthday but is unsure as to which type of policy would be suitable.

**Questions**

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

**(a)** Write down a list of questions you would want to ask Margaret to obtain all the information required to enable you to advise her on her retirement planning. *In order to gain marks, these questions should be written in question form in such a way that Margaret will understand them.* **(10)**

**(b)** Calculate, **showing all your workings**, the maximum, net, tax relievable single contribution that Margaret could pay into her personal pension plan in the tax year 2011/2012 excluding any carry forward of unused allowances. *Assume that Margaret will continue to pay her regular contributions.* **(4)**

**(c)** Identify the **similarities** and **differences** between final salary and money purchase pension arrangements. **(10)**

**(d)** State why Margaret might take the maximum pension commencement lump sum (tax-free cash) from her pension funds. **(4)**

**(e)** Compare a whole of life policy and a level term policy by stating **three** advantages and **three** disadvantages of each product. **(12)**

**(f)** Compare an accident, sickness and unemployment policy with an income protection policy as a way of protecting Margaret's income by stating the **benefits** and **drawbacks** of each product. **(10)**

**Total marks available for this question: 50**

**Questions continue over the page**

**Question 2**

You are authorised to conduct business under the Financial Services and Markets Act (FSMA) 2000 and qualified to provide financial advice. The information provided is accurate and adequate for the purpose of these questions.

Read the following carefully, then carry out **ALL** of the tasks **(a)**, **(b)**, **(c), (d)** and **(e)** which follow.

**INFORMATION**

Claire and Brian, both aged 37, are married with two children, Jenny, aged 14, and Paul, aged 12.

Claire is employed as a part-time teacher in a local school on a salary of £12,000 per annum and has been a member of the Teachers' Pension Scheme since starting work.

Brian works as a self-employed writer and has earnings of £50,000 per annum for the last three years. He contributes £500 per month, net, into a personal pension plan and usually tops this up with a net single contribution of £4,000 each year.

Claire and Brian currently have £350,000 in a joint bank account following a lottery win and need your advice on investing this amount for growth and income. They plan to extend their home with a conservatory in 12 months' time which will cost £30,000. They would like an emergency fund of at least £25,000 with a competitive rate of interest.

Claire and Brian wish to invest the £350,000 between low and medium risk products and they have stated that they do not want any high risk investments. They require a net income of £4,000 per annum from their portfolio to start a separate account to save for university fees for both children. They are also considering the possibility of putting this amount into Junior ISAs for the children and would like to know more about these.

They are looking for diversification and tax efficiency. They would also like your advice regarding in whose name the investments should be held. They have specifically stated that they would like income to come from at least three different product types.

Claire and Brian have no mortgage or debts. They have no other savings or investments.

A friend has told Claire and Brian that the Financial Services Compensation Scheme only protects money held on deposit and not if invested elsewhere. They would like your clarification with regard to all that the scheme covers.

**Questions**

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

**(a)** Detail the limits set by the Financial Services Compensation Scheme and explain briefly to Claire and Brian how the scheme operates. **(6)**

**(b)** State the basic features of a Junior ISA. **(4)**

**(c)** **(i)** Recommend from the product list on pages 8 to 11, a portfolio of products that will meet Claire and Brian's requirements, showing the amount to be invested in each product. State clearly in whose name each product is to be held. **(9)**

**(ii)** Show how the portfolio recommended in **(c)(i)** above, will generate the income that Claire and Brian require and state clearly, in words, the tax treatment of each product you have used to provide the income. **(9)**

**(d)** For each of the product types you have selected in **(c)(i)** above, including the non-income producing products, justify your recommendations under the following headings:

- the amount of the investment;
- the risk profile;
- the justification of the product type. **(18)**

**(e)** Other than an annual review, state **four** other events that would trigger a review with a client. **(4)**

**Total marks available for this question: 50**

## PRODUCT LIST

**This list to be used in answering question 2.**

The products included in this list are to be used when recommending lump sum/single premium products to meet assessed client needs. Although the list is not exhaustive, it does provide the candidate with considerable choice and should be considered adequate for the task in hand. The details provided are either factual, e.g. National Savings and Investments Products, or fictitious products based on real examples, e.g. the list of unit trust/OEIC funds and their yields. AER means annual equivalent rate.

### 1. Bank and Building Society Accounts – UK

| | Gross yield/AER |
|---|---|
| AnyBank High Interest Cheque Account (min £1) | 0.20% |
| AnyBank Deposit Account (min £10) | 0.90% |
| Shires Building Society Postal Account (Min £5,000) | 2.20% |
| Shires Building Society 90 Day Notice (min £10,000) | 1.95% |
| AnyBank 60 Day Account (min £15,000) | 1.90% |
| Other Bank 1 Year Account (min £10,000) | 3.50% |
| Other Bank Internet Account (min £1,000) | 2.50% |

### 2. Bank and Building Society Offshore Accounts – Jersey based

| | Gross yield/AER |
|---|---|
| Other Bank Super Deposit Account (min £15,000) | 2.50% (paid gross) |
| Shires Building Society Offshore Deposit (min £20,000) | 2.25% (paid gross) |
| AnyBank Island Account (min £5,000) | 2.00% (paid gross) |

### 3. ISAs Cash Component

| | Term | Gross yield/AER | Investment Minimum £ |
|---|---|---|---|
| AnyBank | No notice | 3.00% | 1 |
| A & G | No notice | 3.05% | 1 |
| Axis Insurance | No notice | 3.30% | 1,000 |
| NS ISA | No notice | 2.50% | 100 |
| Shires Building Society | 30 Day | 3.25% | 1,000 |

4. **Unit trusts and OEICs –**
**for ISA Stocks and Shares Components and for Direct Investment outside ISAs**

| | | Gross yield |
|---|---|---|
| AnyBank | UK Equity Income | 1.8% |
| | UK Gilts | 2.0% |
| | International Equity | 1.0% |
| A & G | UK Equity Income | 5.2% |
| | UK Corporate Bond | 5.0% |
| | UK Gilts | 3.3% |
| | UK Equity Environment | 1.0% |
| Eagle | UK Equity Growth | 0.8% |
| | UK Smaller Companies | 0.6% |
| | UK Gilts | 4.9% |
| | Europe Equity | 0.3% |
| | US Equity | 0.1% |
| | Far East Equity | 0.0% |
| | Technology | 0.0% |
| Trust Insurance | UK Equity Income | 2.8% |
| | UK Index Tracker | 1.6% |
| | Europe Equity | 0.3% |
| | International Equity | 0.5% |
| | Fund of Funds | 1.5% |
| | Property | 1.0% |
| Axis Insurance | UK Equity Income | 1.4% |
| | UK Equity Growth | 0.7% |
| | UK Corporate Bonds | 4.8% |
| | International Equity | 0.6% |
| Professional | UK Index Tracker | 1.8% |
| | UK Recovery | 1.0% |
| | UK Gilts | 4.0% |
| | International | 0.0% |

**Note:** Share exchange facilities are available.
Both INCOME AND ACCUMULATION units are available.

**5. National Savings and Investments (NS&I)**

| | Gross yield |
|---|---|
| Investment Account (£20 to £1,000,000) | *Note (i)* |
| Income Bond (£500 to £1,000,000) | *Note (ii)* |
| * Children's Bonus Bond (£25 to £3,000) | 2.50% |
| ISA *Note (iii)* | 2.50% |
| Premium Bond *Note (iv)* | 1.50% |
| * 5 year NSC 97th Issue | 2.25% |
| * 5 year NSC 48th Index- linked | +0.50% |

Note (i) 0.20% gross paid on holdings under £25,000
0.30% gross paid on holdings of £25,000 or more
Note (ii) 1.45% gross paid on holdings under £25,000
1.75% gross paid on holdings of £25,000 or more
Note (iii) Minimum investment £100
Note (iv) Monthly tax-free prizes.
(*Tax free)

**6. Insurance guaranteed income bonds**

**Note to candidates:** these are insurance-based products, rather than derivatives-based or so-called "precipice bonds."

| | Yield net of basic rate tax |
|---|---|
| Trust Insurance 1 year income bond | 1.90% (rate guaranteed) |
| Invicta Insurance 3 year income bond | 2.50% (rate guaranteed) |
| Trust Insurance 4 year income bond | 2.75% (rate guaranteed) |
| Axis Insurance 5 year income bond | 2.85% (rate guaranteed) |

**7. UK Insurance bonds – Unit linked**

| |
|---|
| Invicta Insurance Managed |
| Invicta Distribution Fund |
| Axis Insurance UK Equity Growth |
| Axis UK fixed interest |
| Axis Insurance Property |
| Sea Life Pacific |
| Sea Life North American |
| Arrow Life European |
| Arrow International Equity |

8. **With-profits bonds**

| |
|---|
| Arrow Life With-profits Bond |
| Celtic Mutual With-profits Bond |
| Axis Provident With-profits Bond |

9. **Pension Funds**

| | Stakeholder |
|---|---|
| Trust Pensions UK Tracker Fund | ✓ |
| Trust Pensions Managed Fund | ✓ |
| Invicta Pensions UK Equity Fund | - |
| Celtic Mutual UK Fixed Interest Fund | ✓ |
| Celtic Mutual Emerging Markets Fund | - |
| Axis With-Profits Fund | - |

# INCOME TAX

| RATES OF TAX | 2010/2011 | 2011/2012 |
|---|---|---|
| Starting rate for savings* | 10% | 10% |
| Basic rate | 20% | 20% |
| Higher rate | 40% | 40% |
| Additional rate | 50% | 50% |
| Starting-rate limit | £2,440* | £2,560* |
| Threshold of taxable income above which higher rate applies | £37,400 | £35,000 |
| Threshold of taxable income above which additional rate applies | £150,000 | £150,000 |

**restricted to savings income only and not available if taxable non-savings income exceeds starting rate band.*

| MAIN PERSONAL ALLOWANCES AND RELIEFS | | |
|---|---|---|
| Income limit for Personal Allowance § | £100,000 | £100,000 |
| Personal Allowance (basic) § | £6,475 | £7,475 |
| Personal Allowance (age 65-74) § | £9,490 | £9,940 |
| Personal Allowance (aged 75 and over) § | £9,640 | £10,090 |
| Married/civil partners (minimum) at 10% † | £2,670 | £2,800 |
| Married/civil partners (age 75 and over) at 10% | £6,965 | £7,295 |
| Income limit for age-related allowances | £22,900 | £24,000 |
| Blind Person's Allowance | £1,890 | £1,980 |
| Enterprise Investment Scheme relief limit on £500,000 max | 20% | 30% |
| 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.*
† *where at least one spouse/civil partner was born before 6 April 1935.*

| | | |
|---|---|---|
| Child Tax Credit (CTC) | | |
| - family element | £545 | £545 |
| - family element baby addition | £545 | Withdrawn |
| CTC usually reduced by 41% of joint income (6.67% for 2010/2011) over | £50,000 | £40,000 |

# NATIONAL INSURANCE CONTRIBUTIONS

| Class 1 Employee | Weekly | Monthly | Yearly |
|---|---|---|---|
| Lower Earnings Limit (LEL) | £102 | £442 | £5,304 |
| Primary threshold | £139 | £602 | £7,225 |
| Upper Accrual Point | £770 | £3,337 | £40,040 |
| Upper Earnings Limit (UEL) | £817 | £3,540 | £42,475 |

| Total earnings £ per week | CLASS 1 EMPLOYEE CONTRIBUTIONS | |
|---|---|---|
| | Contracted-in rate | Contracted-out rate |
| Up to 139.00* | Nil | Nil |
| 139.01 – 770.00 | 12% | 10.4% |
| 770.01 – 817.00 | 12% | 12% |
| Above 817.00 | 2% | 2% |

** This is the primary threshold below which no NI contributions are payable. However, the lower earnings limit is £102 per week. This £102 to £139 band is a zero rate band introduced in order to protect lower earners' rights to contributory State benefits e.g. Basic State Pension.*

| Total earnings £ per week | CLASS 1 EMPLOYER CONTRIBUTIONS | | |
|---|---|---|---|
| | Contracted-in rate | Contracted-out rate | |
| | | *Final salary* | *Money purchase* |
| Below 136.00** | Nil | Nil | Nil |
| 136.01 – 770.00 | 13.8% | 10.1% | 12.4% |
| 770.01 – 817.00 | 13.8% | 13.8% | 13.8% |
| Excess over 817.00 | 13.8% | 13.8% | 13.8% |

*** Secondary earnings threshold.*

| | |
|---|---|
| **Class 2 (self-employed)** | Flat rate per week £2.50 where earnings exceed £5,315 per annum. |
| **Class 3 (voluntary)** | Flat rate per week £12.60. |
| **Class 4 (self-employed)** | 9% on profits between £7,225 - £42,475 plus 2% on profits above £42,475. |

# PENSIONS

| TAX YEAR | LIFETIME ALLOWANCE | ANNUAL ALLOWANCE |
|---|---|---|
| 2006/2007 | £1,500,000 | £215,000 |
| 2007/2008 | £1,600,000 | £225,000 |
| 2008/2009 | £1,650,000 | £235,000 |
| 2009/2010 | £1,750,000 | £245,000 |
| 2010/2011 | £1,800,000 | £255,000 |
| 2011/2012 | £1,800,000 | £50,000 |

**ANNUAL ALLOWANCE CHARGE**
20% - 50% member's tax charge on the amount of total pension input in excess of the annual allowance.

**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, which is subsequently taxed under PAYE.

# INHERITANCE TAX

| RATES OF TAX ON DEATH TRANSFERS | 2010/2011 | 2011/2 |
|---|---|---|
| Transfers made after 5 April 2011 | | |
| - Up to £325,000 | Nil | Nil |
| - Excess over £325,000 | 40% | 40% |
| - Lifetime transfers to and from certain trusts | 20% | 20% |

| MAIN EXEMPTIONS | | |
|---|---|---|
| Transfers to | | |
| - UK-domiciled spouse/civil partner | No limit | No limit |
| - non-UK-domiciled spouse/civil partner (from UK-domiciled spouse) | £55,000 | £55,000 |
| - UK-registered charities | No limit | No limit |
| 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 | £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% |

# MAIN SOCIAL SECURITY BENEFITS

| | | 2010/2011 | 2011/2012 |
|---|---|---|---|
| | | £ | £ |
| Child Benefit | first child | 20.30 | 20.30 |
| | subsequent children | 13.40 | 13.40 |
| Employment and Support Allowance | Assessment Phase | | |
| | Age 16 – 24 | N/A | Up to 53.45 |
| | Aged 25 or over | N/A | Up to 67.50 |
| | Main Phase | | |
| | Work Related Activity Group | N/A | Up to 94.25 |
| | Support Group | N/A | Up to 99.85 |
| Attendance Allowance | lower rate | 47.80 | 49.30 |
| | higher rate | 71.40 | 73.60 |
| Retirement Pension | single | 97.65 | 102.15 |
| | married | 156.15 | 163.35 |
| Pension Credit | single person standard minimum guarantee | 132.60 | 137.35 |
| | married couple standard minimum guarantee | 202.40 | 209.70 |
| | maximum savings ignored in calculating income | 10,000.00 | 10,000.00 |
| Bereavement Payment (lump sum) | | 2,000.00 | 2,000.00 |
| Widowed Parent's allowance | | 97.65 | 100.70 |

# CAPITAL GAINS TAX

| EXEMPTIONS | 2010/2011 | 2011/2012 |
|---|---|---|
| Individuals, estates etc | £10,100 | £10,600 |
| Trusts generally | £5,050 | £5,300 |
| Chattels proceeds (restricted to five thirds of proceeds exceeding limit) | £6,000 | £6,000 |

| TAX RATES | | |
|---|---|---|
| Individuals: | | |
| Up to basic rate limit | 18% | 18% |
| Above basic rate limit | 18%/28%* | 28% |
| Trustees and Personal Representatives | 18%/28%* | 28% |
| Entrepreneurs' Relief – Gains taxed at: | 10% | 10% |
| Lifetime limit | £5,000,000 / £2,000,000** | £10,000,000 |

For trading businesses and companies (minimum 5% employee or director shareholding) held for at least one year.

**   18% rate applies to disposals on or before 22/06/10.  28% thereafter.*
***  For disposals 06/04/10 to 22/06/10: £2,000,000.  £5,000,000 until 05/04/11*

# CORPORATION TAX

| | 2010/2011 | 2011/2012 |
|---|---|---|
| Full rate | 28% | 26% |
| Small companies rate | 21% | 20% |
| Small companies limit | £300,000 | £300,000 |
| Effective marginal rate | 29.75% | 27.5% |
| Upper marginal limit | £1,500,000 | £1,500,000 |

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