CISI Level 6 Certificate in Financial Planning

June 2019

CHIEF EXAMINER’S REPORT
ADVANCED FINANCIAL PLANNING

This is a pilot paper with only a few candidates sitting the exam. The candidates were trainers and so were not representative of a typical candidate. The average pass rate of 83%, therefore, should not be expected to represent the standard.

The results per section were similar for Sections A and C whilst Section B had the lowest score, where a lack of depth and a lack of relevance were the main contributory factors.

In Section A, candidates scored well but many struggled with Q7 (calculate monthly contribution), and Q9 (perceived and real impediments).

In Section B, both questions were attempted by candidates but Q11 (The benefits and drawbacks of using lifetime cashflow modelling tools) was more popular.

In Section C, candidates did exceptionally well with the average mark being 88%. Most of the case study was well answered, with the weakest part being Q13(d) regarding the tax treatment of redundancy payment.

The answers outlined are not all-inclusive; marks are awarded for other relevant points. Furthermore, it is not necessary to include all points outlined in order to earn full marks. Good answers will often expand on points listed and include topical illustrations.
CONCLUSIONS AND GENERAL OBSERVATIONS

Many scripts were well presented, with candidates using double-spacing, numbering, underlining, and sensible use of paragraphs, and different colour pens. The best scripts demonstrate a succinctness and clarity in summarising the essentials of the answer.

Many questions ask for a specified number (often THREE) of reasons, differences, advantages, etc. Some candidates exceed this number. In such cases, points listed in excess of those specified are ignored.

Common and recurring shortcomings in Section B are not answering the question, writing in a descriptive and unstructured manner. Good answers are those which answer the question and are supported by contemporary examples.

Section A

Q1. Explain the difference between financial planning and financial advice.

This is a straightforward question and candidates explained it well.

- Financial planning focuses on planning and strategies to help a client achieve his/her objectives.
- Financial advice focuses on financial products that a client might need to achieve his/her objectives.

Q2. State two purposes of a financial plan.

This is a straightforward question and answers were good.

- Analyse a client’s financial situation.
- Summarise a client’s goals and objectives, and recommendations of actions to take to achieve these.

Q3. Explain the purpose of a net worth statement and income and expenditure statement.

Candidates showed a clear understanding.

- Net worth statement: a summary of capital resources available to achieve goals and objectives.
- Income and expenditure statement: a summary of surplus income available to fund goals and objectives.
Q4. List EIGHT key assumptions commonly used in a financial plan.

No issues with this question.

- Life expectancy
- Inflation rate
- Rates of investment return (savings, bonds, equities)
- State pension age
- National average earnings
- House price increases
- Mortgage interest rate
- Education costs escalation
- Expenditure in retirement
- Tax rates
- Residency and domicile

Q5. David is married and resident in the UK. In the 2019/2020 tax year his salary is £50,000 and he also receives £15,000 in taxable UK dividends. He has a 2-year-old daughter and receives child benefit. He has no other income. Calculate his potential income tax liability for the 2019/2020 tax year and explain what he can do to avoid the Higher Income Child Benefit Charge. Show all your workings.

Some candidates struggled with this question.

Income tax calculation for David 2019/20

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross salary</td>
<td>£50,000</td>
</tr>
<tr>
<td>Dividend income</td>
<td>£15,000</td>
</tr>
<tr>
<td>Gross income</td>
<td>£65,000</td>
</tr>
<tr>
<td>Less: Personal Allowance</td>
<td>£12,500</td>
</tr>
<tr>
<td><strong>Taxable income</strong></td>
<td><strong>£52,500</strong></td>
</tr>
<tr>
<td>Dividend income</td>
<td>£15,000</td>
</tr>
<tr>
<td>Non-savings income</td>
<td>£37,500</td>
</tr>
<tr>
<td>Income tax</td>
<td></td>
</tr>
<tr>
<td>Non-savings income</td>
<td></td>
</tr>
<tr>
<td>£37,500 x 20% =</td>
<td>£7,500</td>
</tr>
<tr>
<td>Dividend income</td>
<td></td>
</tr>
<tr>
<td>£2,000</td>
<td>£0</td>
</tr>
<tr>
<td>£13,000</td>
<td>£2,600</td>
</tr>
</tbody>
</table>
High Income Child Benefit Charge  £269.10
Total income tax liability  £10,369.10

Child benefit: £20.70 a week, or £1,076.40 a year.

David’s income over £50,000 is £2,500, so is required to pay tax of 1% for every £100 over £50,000.

£2,500/100 is 25, so needs to pay 25% of child benefit back as a tax charge.

£1,076.40 x 25% = £269.10.

David’s tax charge will, therefore, be £269.10, leaving him with child benefit of £807.30.

Option to avoid High Income Child Benefit Charge, David can increase his pension contributions. This will reduce his adjusted net income.

Answers to this question vary. Candidates did not show clearly the tax calculations and did not indicate that the first £2,000 of the dividend income was exempt. Some answers to the second part were too brief, listing only one option (transfer assets to spouse).

Q6. List THREE ways to deal with a conflict of interest.

No issues with this question
- Disclose material conflicts of interest
- Manage feelings, prejudices and desires
- Give a client an option to move to another planner

Q7. Sam, aged 30, would like to retire at age 60 with a pension pot of £500,000. Assuming 6% investment growth rate and 1% AMC, calculate the gross monthly contribution he needs to make to achieve this goal.

This should be a straightforward calculation, but some candidates struggled to calculate PMT using a calculator. Others stated the number of payments as 30 instead of 360.

PMT:
rate 5% (6% - 1% AMC= 5%) = 0.005
number of payments: 30 x 12 = 360
PV = 0
FV = 500,000
Monthly contribution required: £497.75
Q8. Briefly explain the following:
   a) the purpose of Annual Review
   • To ensure that the financial plan is current and accurate and that the client is on track to achieve his/her financial and life goals.
   b) items on the agenda of an Annual Review
   • Review a client’s goals, objectives, circumstances, needs, assumptions, health
   • Review external factors (tax legislation, interest rates, inflation rates)
   • Review if financial products are still relevant to a client’s needs

No issues with this question.

Q9. List FOUR perceived and real impediments to the achievement of a client’s objectives.

Many candidates struggled with this question.

Perceived impediments
Limited knowledge of financial products
Lack of understanding of alternative options
Lack of knowledge of alternative options, previous personal experience

Real impediments
Lack of capital resources
Lack of surplus income

Q10. Bill and Ellie are married. They are employed earning £55,000 and £50,000 per annum, respectively. Their death in service is 4 times their annual salary. In addition, they have the following assets:
   - Main residence (joint): £750,000
   - Cash in bank accounts (joint): £30,000
   - Cash ISAs: £45,000 (Bill £20,000, Ellie £25,000)
   - Cars: £25,000 (Bill £15,000, Ellie £10,000)
   - Unit trusts: £20,000 (Bill)
   - SIPP: Bill £250,000 and Ellie £200,000
   - Mortgage £100,000 (joint)
   - Joint life Insurance policy payable on 1st death: £350,000

Prepare a net worth statement assuming Bill had died yesterday and Ellie is still alive.

No issues with this question.
Bill and Ellie

Net worth statement as at 19 June 2019 assuming Bill had died yesterday and Ellie is still alive.

<table>
<thead>
<tr>
<th>Assets</th>
<th>Bill</th>
<th>Joint</th>
<th>Ellie</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Used assets</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Main residence</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cars</td>
<td>£15,000</td>
<td></td>
<td>£10,000</td>
<td></td>
</tr>
<tr>
<td>Cash or cash equivalent</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank accounts</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash ISA</td>
<td>£20,000</td>
<td></td>
<td>£25,000</td>
<td></td>
</tr>
<tr>
<td>Investments</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unit trusts</td>
<td>£20,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SIPP</td>
<td>£250,000</td>
<td></td>
<td>£200,000</td>
<td></td>
</tr>
<tr>
<td>Life insurance</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Joint life insurance 1st death</td>
<td>£350,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Death in service</td>
<td>£220,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross assets</td>
<td>£870,000</td>
<td>£780,000</td>
<td>£235,000</td>
<td>£1,885,000</td>
</tr>
<tr>
<td>Liabilities</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mortgage</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total net worth</td>
<td>£870,000</td>
<td>£680,000</td>
<td>£235,000</td>
<td>£1,785,000</td>
</tr>
</tbody>
</table>
Section B

11) Critically discuss the benefits and drawbacks of using lifetime cashflow modelling tools.

Some candidates did not answer the question and discuss the benefits, but instead focused on the problems of using lifetime cashflow modelling tools. The answers were neither well-structured nor clearly laid out.

<table>
<thead>
<tr>
<th>Benefits</th>
<th>Drawbacks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Visual way for a client to understand income and expenditure patterns now and for the future – provide a glimpse of the future</td>
<td>What rates to use for inflation, investment growth, property growth, national average earnings etc</td>
</tr>
<tr>
<td>Enrich advice and justify annual fees and can help a client to see if they will run out of money</td>
<td>Assumptions might be incorrect</td>
</tr>
<tr>
<td>One way to test a client’s capacity for loss and tolerance of risk</td>
<td>Inaccurate data</td>
</tr>
<tr>
<td></td>
<td>Might give false reassurances to clients</td>
</tr>
</tbody>
</table>

12) Identify FIVE key behavioural biases and explain, using examples, how they affect financial decision making of an individual.

Candidates did not make a distinction between cognitive errors and emotional biases and did not include enough examples to demonstrate the points.

Any of the following:

**Cognitive errors**
- Conservatism
- Confirmation bias
- Representativeness bias
- Illusion of control bias
- Hindsight bias
- Anchoring and adjustment
- Mental accounting
- Framing bias
- Availability bias

**Emotional biases**
Loss aversion

Overconfidence bias

Self-control bias

Status quo bias

Endowment bias

Regret aversion

Section C

13 a) Tony and Anne have never used a financial planner before and do not know the process of financial planning. Explain to them the FPSB’s 6 step process of financial planning.

Candidates showed a good knowledge of the process, but some answers were too brief.

1. Establish and define the relationship with the client
   - Planner informs the client about the process and services
   - Disclose any conflicts of interest
   - Scope of engagement outlined and agreed (responsibilities of each party, terms of engagement, compensation and conflicts of interest)
   - Formal document by both parties and includes a process for terminating the engagement

2. Collect the client’s information
   - Planner identifies the client’s personal and financial objectives, needs and priorities
   - Planner collects data

3. Analyse and assess the client’s financial status
   - Planner analyses the client’s information to gain an understanding of the client’s financial situation
   - Planner assesses the strengths and weaknesses of the client’s current financial situation and compares them to the client’s objectives, needs and priorities

4. Develop the financial planning recommendations and present to the client
   - Planner considers one or more strategies that could reasonably meet the client’s objectives, needs and priorities
   - Planner develops the financial planning recommendations based on selected strategies and presents the recommendations with a supporting rationale

5. Implement the financial planning recommendations
   - Client accepts the recommendations
   - Planner implements these
   - Planner identifies and presents appropriate products and services

6. Review the client’s situation
   - Planner and client agree terms for reviewing and re-evaluating the client’s situation (goals, risk profile, lifestyle and other relevant changes)
13 b) Tony is worried about the income tax implication of his redundancy package. Briefly explain the taxation of redundancy payments.

Some candidates were not sure about the tax-free amount.

Up to £30,000 of redundancy pay is tax free.

Any non-cash benefits that form part of your redundancy package, such as a company car or computer, will be given a cash value and added to your redundancy pay for tax purposes.

This might then take it over the £30,000 limit.

13 c) They would like to know if they have done the right thing by gifting money to their sons. Explain the advantages and disadvantages of making the gift and how the gift will be treated for the purposes of inheritance tax planning.

Some candidates did not discuss the advantages and focused largely on the tax treatment.

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Straightforward strategy to reduce IHT liability on death</td>
<td>Affordability: client will lose control of the asset and so they need to be absolutely certain that they can afford to give away the asset</td>
</tr>
<tr>
<td>Allow the children to access their inheritance now when they need the money rather than wait until later</td>
<td></td>
</tr>
<tr>
<td>Have the pleasure to see the impact the gift makes on children’s lives</td>
<td></td>
</tr>
</tbody>
</table>

Making a gift to children is a potentially exempt transfer (PET). At the time the PET is made, there is not a liability to IHT and no need to report to HMRC. The PET is included in the ongoing cumulation for IHT purposes. The donor must survive 7 years for the gift to fall outside of the estate for IHT purposes.

13 d) Tony and Anne are worried that they might not have enough income in retirement. Based on the information given, and assuming an annuity rate of 4%, investment growth of 6% per annum, AMC 1% per annum, and SPA of 67, calculate how much gross income they are each likely to get in retirement. Show all your workings.

Candidates did well in this section.
<table>
<thead>
<tr>
<th>Types of income</th>
<th>Tony (in today’s terms)</th>
<th>Anne (in today’s terms)</th>
</tr>
</thead>
<tbody>
<tr>
<td>State pension (1)</td>
<td>£168.60* 52 = £8,767 pa</td>
<td>£168.60*52 = £8,767 pa</td>
</tr>
<tr>
<td>Occupational pension (2)</td>
<td></td>
<td>25<em>1/80</em>£105,000 = £32,812 per year</td>
</tr>
<tr>
<td>Personal pension – SIPP (3)</td>
<td>£265,000*1.03^11 = £366,821 (investment growth = 6% - 1% AMC, 2% inflation = 3% growth)</td>
<td>Value in 11 years’ time: £366,821 * 4% annuity rate = £14,672 p.a.</td>
</tr>
<tr>
<td>Rental income (4)</td>
<td></td>
<td>£1100-500-£100=£500*12= £6,000 net rental income per year</td>
</tr>
<tr>
<td>Total income per year</td>
<td>£23,439 p.a.</td>
<td>£47,579 p.a.</td>
</tr>
<tr>
<td>Total joint income</td>
<td></td>
<td>£71,018 p.a.</td>
</tr>
</tbody>
</table>

Notes:
1. Assume that the State pension increases in line with CPI.
2. Assume that the NHS pension revalues in line with CPI.
3. Assume that the investment growth rate is 6%, less 1% AMC, 2% inflation, to give a net growth rate of 3%.
4. Assume that the amount of rental income and mortgage payment remains the same and other costs amount to £100 per month.

13 e) Briefly explain THREE retirement income options for Tony.

Candidates showed a good knowledge of the options.

Flexible income: funds remain invested to provide a regular income. Tony decides how much to take and when

Lifetime annuity: buy a lifetime annuity to give a guaranteed income for life

Take the whole pot in one go: 25% is tax free and the rest is taxable
13 f) List FOUR considerations that should be given to the transfer of Anne’s business from her to Victor at age 60.

Generally, candidates showed a good understanding. One raised a good point about the issue of equity. However, there was a limited understanding of entrepreneur’s relief and CGT.

- **Value of Anne’s shares**
- **CGT**: CGT applied when shares are sold, and entrepreneur’s relief reduces CGT to 10% on the first £10m and 28% on excess
- **IHT**: net amount of proceeds received from the sale of shares is potentially exposed to IHT at 40%. However, Anne could use the proceeds and reinvest in assets which are IHT exempt (AIM-traded companies, but she needs to hold them for 2 years)

**Does Anne need the money from the business?** If not, she could retain the shares until death and leave the shares to her son in her will. Her shares would then pass to him free of IHT if business property relief is applied. Her son would inherit the shares at their market value at the date of Anne’s death for CGT purposes.