



**SECURITIES & INVESTMENT INSTITUTE MASTERS IN WEALTH
MANAGEMENT
WINTER 2008**

**CHIEF EXAMINER'S REPORT-
APPLIED WEALTH MANAGEMENT**

Introduction

This was the first time this paper had been attempted by candidates. Twenty –five candidates sat the examination. The range of marks achieved was 46%. Candidates need to ensure they familiarise themselves with the meaning of the level descriptors used at Masters level. For example, evaluate asks candidates to consider the pros and cons of an issue not to just describe it. Please read the rubric carefully and start each section on a new page. Try to write neatly and ensure bullet points are professionally presented. Current market knowledge should be included where appropriate. Please time the paper carefully and ensure answers have enough detail in them. The sections do not need to be answered in any specific order.

Section A

Question One

Answered by 12 candidates. Reasonably well answered but the greater majority of candidates omitted reporting frequency to clients as a key area

Question Two

Answered by 13 candidates. Candidates had the right idea in principle but more details were needed to gain higher marks

Question Three

Answered by 22 candidates. One excellent answer provided and two good ones but many candidates preferred to dwell on the gearing of hedge funds as being a key risk area. It is very important, of course, but is not the only critical factor.

Question Four

Answered by 24 candidates. Some good answers here but detail lacking in some cases

Question Five

Answered by 18 candidates. The majority of candidates made a reasonable attempt at this question

Question Six

Answered by 11 candidates. This was a straightforward question so it was disappointing that the answers were not better. Several candidates omitted to mention the specified survival period

SECTION B

Question 7

- a) The average mark was 2. Most candidates, but not all, knew what the allowances are
- b) The average mark was 2.1. Several answers only mentioned residential property and forgot tangible moving assets
- c) The average mark was 2.1. The best candidates got this completely right.
- d) The average mark was 3.7. A key omission was the special rules for investments in the shares in a sponsoring employee
- e) The average mark was 3.8. Good answers here but, although the descriptor to the question was 'evaluate', the drawback that this can be an inflexible approach if a client changes his/her retirement plans was not mentioned and should have been.

Question 8

- a) The average mark was 4.16. This question was answered well, on the whole, although some candidates did not define 'collectables' at all and often there was too much concentration on racehorses.
- b) The average mark was 4.56. Candidates had obviously revised this topic area for the most part and there were some excellent, full, answers
- c) The average mark was 4.28. Candidates struggled with this question. They pointed out the inconsistency of the client's wishes but did not think to question how risky her current portfolio is or state that a risk questionnaire would have to be completed. One candidate stated, quite rightly, that if Mary persisted in wanting huge return for little risk he/she would be forced to refuse to have her as a client. This was a point well made. Others were more sanguine!

SECTION C

Question 9

- a) The average mark was 0.84. The point about the need to sever the joint tenancy of property was not mentioned. There was some discussion of giving away £3000 per annum which is not particularly effective when you consider the size of their portfolio! Candidates who mentioned the recent changes to the law gained marks.

- b) The average mark was 3.08. This question was reasonably answered on the whole. There was considerable differences between candidates in terms of their opinions as to what constitutes the correct number for a diversified portfolio of shares. Not all candidates spelt out how much money would be put where.
- c) The average mark was 3.4. Good knowledge of the three types of bonds displayed here. Liquidity was not always mentioned nor were spreads
- d) The average mark was 4.88. Good answers from many candidates to this straightforward question
- e) The average mark was 2.88. A few candidates did not write enough to gain many marks
- f) The average mark was 6.2. Good attempts from candidates to come up with a portfolio. Weaker candidates did not specify who should own what. There was a worrying tendency to put 10% of the client's money into hedge funds and a further 5% into commercial property by some candidates which did not fit the risk profile. Very few made any use of tax free National Savings products. Portfolios should be tabulated.
 - fii) The average mark was 5.4. There were some really full answers here which is to the candidates' credit at the end of a three hour exam paper

The majority of candidates finished the paper but a couple appeared to run out of time. More detailed answers need to be written by candidates if they want to gain high marks at Masters Level.

The following information is provided for solely for the guidance of candidates and should not be read as providing a model answer, nor, in some instances as the only possible response.

SECTION A

1. Appropriateness of complex instruments

- Reporting frequency
- Reporting to clients
- Inducements
- Agreed benchmarks
- Best execution
- Suitability of product

1 mark per point max 5 marks

2. A passport allows a firm authorised in a EEA state to ‘passport’ that authorisation into another EEA state without having to participate in a full application for authorisation in that state.

A firm wishing to passport must apply to its home State regulator providing information about the activities and locations they require the passport to cover.

The firm must have its head office in an EEA country.

The passport only allows coverage in the host State that the firm is authorised to do in the home State.

MiFID allows passporting for a wider range of activities.

Where a branch is set up host State rules will continue to apply.

A tied agent established in the EEA will be able to act on behalf of a firm instead of the firm setting up a branch.

1 mark per point max 5 marks

3. Serious market disruption and erosion of confidence

- Market abuse/insider trading and manipulation

- Control and operational issues

- Mis-valuation of complex illiquid instruments/fraud

- Preferential treatment of investors

1 mark per point max 5 marks

4. Technically a single premium life assurance policy.

There is a life cover element which is typically 101% of the bid value of the units purchased.

The premium paid is invested in the units of the life assurance company.

The investor can take an income from the bond or have this reinvested in additional units.

There is an option of withdrawing up to 5% of the capital sum each year on a cumulative basis.

These withdrawals are free of tax when made but will increase the final tax liability on the bond’s maturity.

Any profit on encashment, including previous ‘tax-free’ withdrawals is subject to income tax

1 mark per point max 5 marks

5. Taxed as income tax so no capital allowance **1**

$(£550,000 + £200,000) - (£500,000 + £40,000) = £190,000$ **2**

$£190,000/10 = £19,000$ per annum. **1**

Add £19,000 to income if HRT whole gain will be taxed at 40% **1** **5 marks**

6. Pays out after specified survival period normally 14 or 28 days after diagnosis of a critical illness.

Often marketed on a 'stand alone basis' on term assurance principles whereby pays out a lump sum following diagnosis

Will not pay out if illness outside policy term

Can be attached to mortgage protection policies

Normally written on an own (single) life basis

Available as 'bolt on' to life assurance policies

'Bolt on' advanced payment of death sum assured

Unit-linked whole of life policy can be written so payment of sum assured on death is accelerated

'Bolton' can reduce premium costs but cover ceases when first claim made

Permanent cover is when cover is not limited to a specific term but continues premiums are being paid

1 mark per point max 5 marks

SECTION B

7a Maximum Annual Allowance £235,000

Lifetime Allowance £1.65m **1**

If annual limits are exceeded, there is a tax charge made via self- assessment **1**

If the lifetime allowance is exceeded as a pension or a lump sum, there are additional tax charges **1** **3 marks**

7b Taxable property includes residential property and most tangible moving assets such as art, antiques, jewellery, fine wine, classic cars and yachts. **2**

A tax charge would be levied **1** **3 marks**

7c If a scheme invests in taxable property the amount invested is treated as an unauthorised member payment subject to a 40% tax charge on the member and a scheme sanction charge at a minimum of 15% and possibly an unauthorised member payment surcharge of a further 15%. **3**

There will also be a tax charge on income generated through the scheme sanction charge at 40%. **1**

Capital gains on the disposal of an asset will be subject to the scheme sanction charge at 40%.

1

Max 3 marks

7d Shares and property – asset backed investments – are the main investment strategy of such schemes. **1**

There are special rules for investments in the shares in a sponsoring employer. **1**

There is no restriction in quoted shares or collective investments such as unit trusts or pension funds offered by insurers. **1**

Commercial property is an acceptable investment. This can be either directly in a specific property or through a collective investment or insurance company fund. **1**

Holdings in residential property via a genuinely diversified commercially available collective investment vehicle or insurance fund would be acceptable. **1**

1 mark per point max 5 marks

7e Based on investing in relatively high risk areas whilst the individual is young and the remaining period before benefits are drawn are long

As retirement approaches the fund is moved across to more secure areas such as cash or fixed interest investments

The programme of switches is automatic

Idea is to reduce risk

Prescriptive and inflexible approach

Need to take into account individual circumstances which lifestyle does not do

If individual decides to retire earlier or later than expected the approach should be geared to actual retirement plans rather than the norm

1 mark per point max 6 marks

8a Collectibles include works of art, antiques, coins, stamps, veteran cars, wine, limited edition books, diamonds, gold items. They very rarely generate excellent returns in a short space of time and therefore do not meet her investment criteria. There is also considerable potential for losing money on them **2**

Collectibles as an investment have the following disadvantages:

Don't normally produce any income

Can be difficult to obtain an accurate valuation

Values can change as fashions change

They are expensive to keep and insure

The cost of buying and selling them can be high with dealers' margins and often substantial commission costs

The marketability can be low and it may be difficult to sell items in a hurry

The market is not generally regulated

less knowledgeable investors may be vulnerable to the unscrupulous expert

1 per two points

Max 6 marks

8b VCTs are companies that invest in unquoted trading companies. The investor can spread their risk over several of these at the same time.

There are tax benefits to this scheme – a tax reduction of 30% of the amount invested to the permitted maximum of £200,000 in the year making the investment, dividends received from the VCT are exempt from further tax within the permitted maximum.

In addition, capital gains on the sale of shares are exempt from CGT within the permitted maximum.

A VCT must be approved by HRMC and not be a close company and its income must be wholly or mainly derived from shares and securities. 70% by value of the VCTs investments must be in shares or securities which are qualifying holdings. 30% by value of the qualifying holdings must be in the form of eligible shares (ordinary shares carrying no preferential rights in respect of dividends, assets or redemption).

No holding in any company other than another VCT may exceed 15% by value of the VCTs investments.

The VCT must not retain more than 15% of the income it derives from shares and securities.

The advantages for Mary are the tax breaks – can claim a reduction in their tax liability of up to 30% of the amount subscribed.

The investment which qualifies as a tax reducer is limited to £200,000 per annum.

Mary will need to hold the shares for a five year period to retain the tax benefits.

Another advantage is tax-free dividends but Mary would need to acquire the shares at the time when the company qualified as a VCT – limit of £200,000 and get CGT exemption only if meets the test for the dividends.

This is a high risk investment and performance among VCTs is very variable. This is also not a short term investment which does not suit Mary's profile

1 per 2 points

Max 6 marks

8c Mary mentions setting up a foundation then appears to drop the idea – is it an objective or not? **1**

The three ideas on investment types all are high risk although she states she is not interested in much risk **1**

She wants to generate a high return quickly but this normally means high levels of risk must be taken **1**

She also has enough to live on but we don't know what her current portfolio is **1**

Is there risk in the products or the overall portfolio? **1**

A risk questionnaire would have to be completed **2**

You would need to seek further clarification on her risk profile **1**

Max 8 Marks

Total 20 marks

SECTION C

9a Need to sever joint tenancy of property and have a tenancy in common.
Include survivorship clause in will. Estate will not pass to spouse unless survive between, say, 30 days to 6 months.
Can use part of NRB on 1st death -> children and less value in estate of second death.
Will need to ensure surviving spouse has access to funds in the interim eg via discretionary trust

2 marks

9b Lump sum available £330,000 and thus £165,000 into gilts and £33,000 into each equity.

Gilts easily bought and sold. Would need low- coupon , capital growth orientated or index – linked stocks . Main risk is loss of purchasing power. Medium coupon gilts

Five equities are inadequate in terms of diversification to reduce risk.

In longer term, equities outperform gilts but any investment in them should be via the mechanism of Unit Trusts/OEICS/Investment Trusts in their case.

Half and half (+ all their other cash and National Savings) is not widely diversified portfolio, even though they are low risk investors

5 marks

9c The investor considering purchasing corporate bonds may be concerned that the profits of the company could be insufficient to pay the interest and repay the debt.

There is, therefore, a higher risk than with a government security and investors will expect to receive a higher return in compensation.

Large companies that are financially secure will not need to offer an interest rate much above that offered by the government. Smaller companies will have to offer very attractive rates to persuade investors to take the risk.

As with other fixed interest securities, the investor in a corporate bond takes the risk that interest rates will rise while he is locked in. He can then sell the bond in the market but the price will have fallen as the yield has become less attractive.

The corporate bond market is generally less liquid, at least for lower quality bonds. This can be a problem in adverse market conditions especially, when it may be difficult to sell stock.

Corporate bond values can be affected by changes in the issuing company's creditworthiness. As a result of the above factors, corporate bonds are generally higher-risk than government stock, and corporate bond yields are generally higher as a result.

Prices of corporate bonds are generally more volatile than prices of government stock.

The spreads between buying and selling prices are usually greater for corporate bonds, and may be as high as the range 7% to 9%.

Credit rating agencies can down grade or upgrade a bond's status and this can affect the company's ability to raise money and prosper. UK gilt rating is AAA

Eurobonds traded in currency other than that of the home state. Normally large corporation's debt. Very large and liquid market

5 marks

9d Advantages of collective investments:

An individual can invest relatively small amounts, perhaps on a regular basis.

The pooling of investments enables the fund to make purchases of securities at lower cost than would be possible for an individual.

The time involved in directly managing one's own portfolio is saved.

The funds are managed by professional fund managers. A fund manager with a good past performance record may be able to repeat the performance in the future.

A wide diversification between different shares and sectors can be achieved: this can be impractical and costly in dealing charges for a small portfolio held by an individual.

Risk is reduced by exposure to a widely diversified spread of investments in the underlying portfolio.

Specialisation in particular sectors is possible.

The investor can gain exposure to foreign stocks, which can be costly and inconvenient for an individual who holds shares directly.

Different funds provide for different investment objectives, such as income or growth, or a combination of both.

Disadvantages of collective investments

The individual can only choose baskets of investments selected by fund managers, not by himself, and this will not suit all investors.

Although the individual does not have to pick individual securities, he still has to choose the fund manager, and different managers' performance can vary widely.

Although 'star' fund managers can have a successful track record with a fund, such 'star' managers may switch jobs, making future management of the fund less certain.

Larger collective funds find it more difficult to invest in shares of companies with a relatively small capitalisation, because of the small quantities of stock available.

Successful collective funds investing in smaller companies can become a victim of their own success if more funds are brought in, as a greater fund size can make it more difficult for such a fund to follow their successful strategy.

7 marks

9e Factors to take into account:

The number of fund managers accessible

The number of funds accessible

Costs involved in switching funds

Whether access is available on a regular premium basis

Any minimum investment

How income is taken from the funds. Some funds allow a programmed series of monthly withdrawals to allow a larger and more regular income (particularly effective to make use of the annual CGT exemption)

Additional services available (such as data and information or access to make switches and make new contributions via internet)

Whether a 'wrap account which can be accessed online

Allows up to date value of the assets and asset allocation

5 marks

9fi Total available:

£330,000	Lump sums from pensions
£ 200,000	Building society
£70,000	Isas
£ 15,000	Bank (Joint)
£25,000	Bank (Rosemary)
£630,000	

Main objective Capital Growth and low risk.

Possible indicative portfolio:

ISAs	£70,000	½ John and ½ Rosemary
Index linked National Savings Certs 3 yr 18th Issue	£30,000	½ John ½ Rosemary
Fixed interest Nat S.Certs 2 yr 44th Issue	£30,000	½ John ½ Rosemary
Index linked National Savings Certs	£30,000	½ John ½ Rosemary
Premium Bonds	£60,000	½ John ½ Rosemary
Zero Dividend Pref Shares	£80,000	½ John ½ Rosemary
Cautious Managed Unit Trusts	£75,000	Rosemary
Global Growth Unit Trusts	£30,000	Rosemary
Money Market Unit Trusts	£120,000	Rosemary
Long term deposit a/c	£40,000	Rosemary
ISA holding account	£35,000	Rosemary
Bank account	£10,000	Joint
	£640,000	

An alternative would be to start investing for the grandchildren now to save some IHT:

£3,000 per child in Issue 31 Children's Bonus Bonds (7%). Add another £3,000 apiece every time a new issue appears

£1,200 per annum per child in a Child Trust Fund.

These monies could come out of the ISA holding account which could then be topped up when nearly empty

8 marks

9fii As stated, current objective capital growth and low risk but given the size of the assets also needs to be tax efficient

Nat Savings Certs are tax free thus maximum holdings in each. Premium Bonds - winnings are tax free also

Zero Dividend Preference Shares between them to use annual CGT exemptions when they are cashed in.

Cautious Managed unit trust has maximum equity exposure of 60%

Global Growth unit trusts have 80% exposure to equities so should be the first one to be run down

Money market unit trusts have 95% of assets in money market instruments so reasonably low risk

All unit trusts to be accumulation units

Deposit account low risk

Bank account for emergencies

Money to be transferred from ISA holding account each year and transferred into £7,200 ISA apiece. AS above could also invest directly for the grandchildren.

Should also increase National Certificate holdings as new issues appear and gradually decrease unit trust holdings for safety and tax purposes

8 marks

NB There isn't a definitive answer to the construction of any portfolio but candidates would gain marks for meeting any income targets (not required here) and for appropriate choices

8 marks